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Uh-oh



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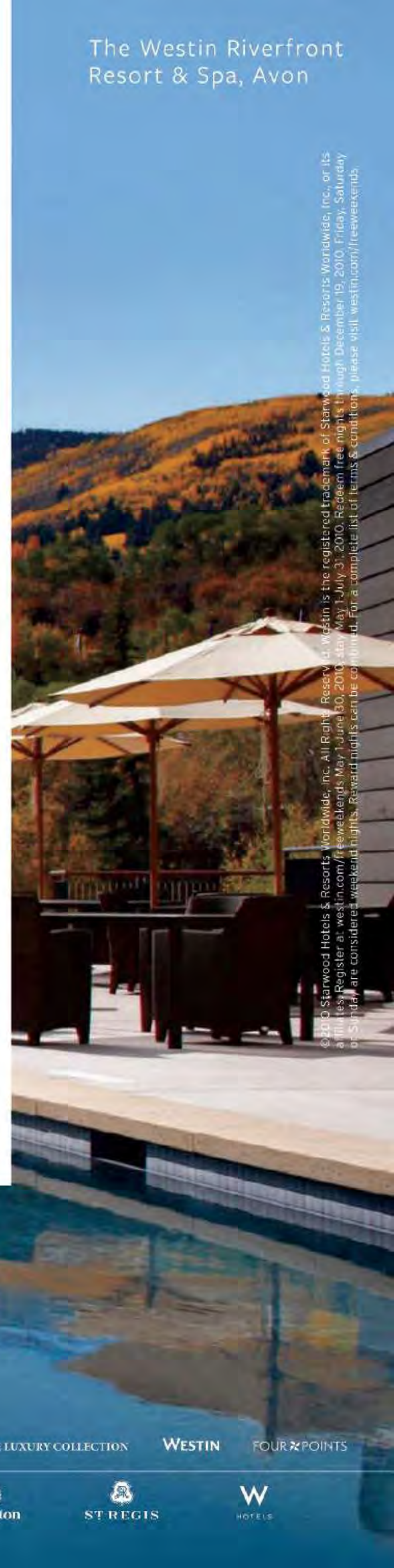
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Corrections & Clarifications

B "Lessons of the Spill" (Cover Story, May 10-16) incorrectly stated that cement is injected into a well in the gap between the drill pipe and its casing. In fact, the cement goes outside of the casing in the gap between the casing and the wall of the hole. B In "When Counties Don't Stop Governing at the Border" (Politics & Policy, May 17--May 23, 2010), Lee Deuben was referred to as "he." Ms. Deuben is a she. B "Quoted" (Politics & Policy, May 17-May 23) incorrectly identified Jaime Dimon as CEO of Citigroup. He is chairman and CEO of JPMorgan Chase.





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Opening Remarks



On May 10, Trichet changed course on buying sovereign bonds

Come Together

The euro zone's crisis can only be solved by unity, says ECB President Jean-Claude Trichet. So why is everyone talking about blowing it up? By Peter Coy

Anyone trying to predict the outcome of Europe's financial crisis should pay close attention to Jean-Claude Trichet. As head of the Bank of France in 1999, he helped create the euro. After seven years babysitting the new specie as president of the European Central Bank in Frankfurt, Trichet and the euro are as intertwined as a man and a currency can be. He is too invested to let it break apart on his watch.

Whatever emotional tug the 67-year-old Trichet may feel, though, is counterbalanced by his devotion to sound money and central bank independence. He doesn't want to debase the euro just to keep shakier members of the zone on board. Even as the financial crisis spiraled out of control, he refused to support weak governments—Greece, Spain, Portugal—by buying up their debt. That restraint burst on May 10. A run on Greek government bonds had begun to spill over into Portuguese, Spanish, and even Italian sovereign debt, raising fears of a self-feeding downward spiral. That day, Trichet reversed course and announced the ECB would begin buying sovereign bonds after all, "to ensure depth and liquidity." That, along with a 750-billion-euro loan package from EU countries, stopped the run and gave the euro some breathing room.

Skeptics and speculators are already questioning whether it was enough. What had been unthinkable—a partial dissolution of the euro zone—is now openly debated. The euro has lost 18 percent of its value since November, 7 percent in the last month alone. As Trichet sees it, there is only one way to guarantee that the euro remains strong and the bloc stays intact: Europe must integrate more tightly than ever.

Having grudgingly extended a lifeline to Greece and other shaky economies, Trichet wants to make sure the debtor nations follow through on their promised austerity measures. He's pushing a plan that would require them to submit their annual budgets to the scrutiny of their peers and ratchet up the penalties on countries whose budgets do not pass muster. Trichet told *Der Spiegel* that Europe needs "a quantum leap in the governance of the euro area."

It's an open question whether Europe can muster the goodwill, and the willpower, to come together in the way Trichet believes is required. German citizens are already angry at Greeks for dragging their currency down and sucking money from their coffers. For Greece, the price imposed by the EU and the International Monetary Fund for continued euro zone membership is a long walk over hot coals—deep budget cuts, steep tax hikes. "What the IMF is asking Greece to do borders on insanity. It's going to drive Greece into a deep recession and increase its debt-to-GDP ratio," says Desmond Lachman, a resident fellow of the conservative American Enterprise Institute in Washington.

European leaders from Germany to Greece are making it clear they won't let the euro zone fracture without a fight. They believe the euro is worth preserving because it encourages trade

UPPA/ZUMA PRESS

and investment among the 16 member nations while promoting financial and geopolitical stability. European multinationals such as Airbus are among the euro's strongest supporters. And from adversity comes a measure of unity: Faced with an existential threat, European political leaders have agreed to risk-sharing measures that were politically impossible in calmer times. The nearly $1 trillion in loans and guarantees announced on May 10 is the best example of this newfound cohesiveness. To the optimists, this painful time is not the death throes of a failed monetary experiment but the birth pangs of a new federation. "We were close to a very, very significant risk of collapse," French Finance Minister Christine Lagarde told CNN after the rescue. "I do think that it's restored credibility and that was the issue."

Her unspoken message: If the euro zone goes, it won't go quietly. German Chancellor Angela Merkel isn't playing around, either. Her government banned traders from buying so-called naked shorts, default protection on government bonds they don't own. Investors, wondering if Merkel knew something they didn't, started selling again.

The world and its businesses have a stake in every bit of this drama. A successful fix for the euro's woes would signal that the global financial crisis of 2008-09 is truly over. If Europe botches the euro and its economy sinks, on the other hand, companies around the world that sell to Europe will suffer, with dangerous spillover to non-European banks and investors exposed to European debt.

The direct exposure of U.S. banks to Greece is fairly trivial: only about $17 billion as of yearend 2009. The far bigger risk is that a Greek default would freeze up financial markets as big players worried about who was on the hook for bad debts. In a sign of that nervousness, the premium banks pay to borrow from one another has widened recently to about 0.25 percentage points over the risk-free overnight swap rate. That's quadruple the spread in early March, although still much lower than the 3 percent-plus spread at the height of the crisis in 2008. "The worry for me is that we're moving from a sovereign debt situation to problems in the banking sector," says Pierre-Olivier Gourinchas, an economist at the University of California at Berkeley.

"What the IMF is asking Greece to do borders on insanity. It's going to drive Greece into... recession"

The U.S. stock market is pricing in those worries, with the Standard & Poor's 500-stock index falling about 8 percent since late April. Although exports to Europe are too small to have much effect on the overall U.S. economy—they account for just 1.7 percent of gross domestic product—certain companies are feeling the pinch. On May 18 consumer products conglomerate Fortune Brands Chief Executive Officer Bruce A. Carbonari said in an analysts' call that "Europe we see continuing to be down, down probably low single digits" in revenue growth. United Technologies, which gets about a quarter of its sales from Europe, started 2010 assuming a $1.48 euro exchange rate. Now it's around $1.24. That makes it more costly to export from the U.S. to Europe and reduces the dollar value of profits earned in euros.

Even so, some companies are racing ahead, says Robert Nardelli, chief executive officer of the operating company of private equity giant Cerberus Capital Management, whose companies in Europe and elsewhere have about $50 billion in annual revenue. "If you're trying to do deals or buy back debt, the speed with which you do something has increased," he says. "You need a quick 'yes' or a quick 'no'– it's not an environment for a slow 'maybe.'"

Corporate leaders in Europe have expressed faith in the single currency, which despite its decline holds about the same value vs. the dollar as it did at inception. "I am convinced that the euro has staying power and won't fall apart," says Daimler CEO Dieter Zetsche. Rival BMW is changing purchasing arrangements to protect profits if the euro rebounds. "The euro could be down today, but could also be up again tomorrow," says Herbert Diess, BMW's management board member in charge of purchasing.

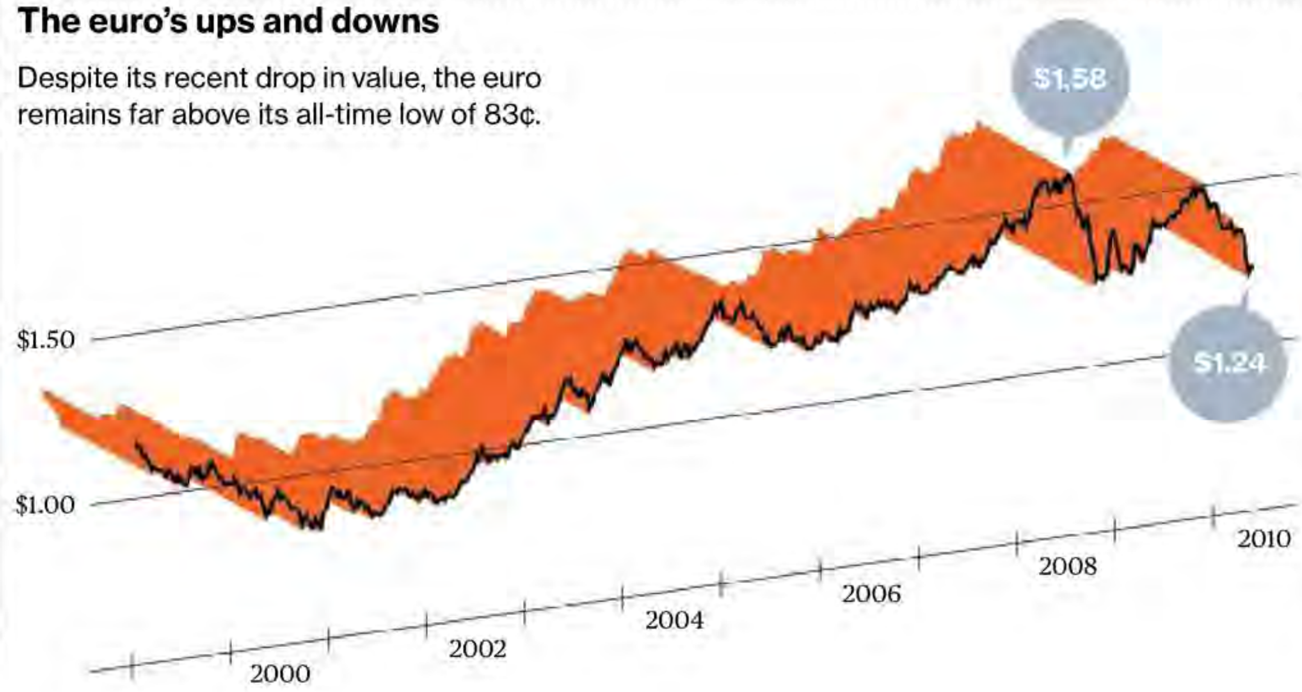
In one important respect, the euro zone has already come partly unglued. Borrowing costs are shooting up for corporations in nations with weak government finances. According to a *Bloomberg Businessweek* analysis, yields on A-rated corporate bonds rose one percentage point in Greece and 0.6 percentage points in Portugal from mid-April through mid-May, while dropping about 0.1 percentage points in France and Germany. In an age of global business, banks are pricing corporate debt locally.

Clearly, stepped-up governance is required. The status quo has been a muddled, halfway affair, combining monetary integration with fiscal independence. Peripheral euro zone members including Greece and Ireland borrowed and spent themselves into trouble while losing their cost competitiveness. Rules limiting the size of deficits as a share of GDP were routinely flouted, not only by those nations but even by Germany. The EU didn't even impose the fines on violators provided for in its Stability and Growth Pact.

Extreme solutions are being bandied about now, but bank on this: The euro zone is not going to leap all the way to a unified taxing and spending authority—a United States of Europe. That would re-

The euro's ups and downs

Despite its recent drop in value, the euro remains far above its all-time low of 83¢.



How Will the Euro Zone Crisis End?

MORE LIKELY ← → LESS LIKELY

Enforce deficit limits—with sanctions



PRO	CON
A clearly necessary step to keep member nations from spending their way into trouble.	Budget deficits are inevitable in recessions. Deciding when they are and aren't acceptable will remain difficult.

Break up the euro zone



PRO	CON
Allows weak nations that leave (perhaps temporarily) to regain cost competitiveness through a currency devaluation.	Proliferation of currencies would complicate trade and investment. Chaos, lawsuits, and national defaults could be the result.

Create a "United States of Europe"



PRO	CON
A unified taxing and spending authority would be the strongest guarantee of euro stability.	It would violate the euro zone treaty, and its infringement on sovereignty would surely be rejected by all member nations. An EU nonstarter.

quire political union, something that is impossible under the Lisbon Treaty (effectively the EU constitution) and politically unthinkable, too. Europeans are in no mood to surrender their sovereignty. "The budget law is a matter of national parliaments," Guido Westerwelle, Germany's Foreign Minister, said in early May.

The other extreme scenario, an exit of one or more countries from the euro, is also difficult. If one of the Southern European countries left the euro, warns Preston Keat, research director of consulting firm Eurasia Group, that "would lead to a sharp depreciation of the 'new' currency relative to the euro. The country's euro-denominated debt would suddenly be much more expensive to service, which would lead to an almost immediate default." Legal chaos would follow, he wrote in a May 19 note, as local companies with contracts linked to the euro are thrown into turmoil, and "all contracts–including those governing wages, bank deposits, bonds, mortgages, taxes, and almost everything else" had to be redenominated in the new currency. "In short, this would violate all kinds of laws and treaties and rules–at the national, EU, and international levels."

All the lawyers in Brussels won't stop Greece from pulling out of the euro zone if ordinary Greeks conclude that membership in the common currency is yoking them to unaffordable debts and chronic high unemployment. If Greece still used the drachma as its currency, it would have lost value against other currencies by now, propping up the economy by making Greek products and services more affordable globally.

The cheaper currency would also make imports more expensive, suppressing domestic consumption. Membership in the euro zone prevents that from occurring.

Ultimately, the euro's future comes down to the willingness of Greeks, Portuguese, Spaniards, and Irish to absorb pain now in return for the benefits of the common currency, including free trade and investment that (in the long run) reduce the cost of living and raise living standards. Spanish Prime Minister José Luis Rodríguez Zapatero has announced the deepest budget cuts in at least three decades. He vowed to press ahead even though the austerity measures dented support for his ruling Socialist Party. Portugal and Greece have also forged ahead with budget cuts and tax hikes.

Greek Prime Minister George Papandreou has one thing going for him, says Elias Papaioannou, an economist at Dartmouth College. Ordinary Greeks want to keep their euro zone membership. They don't want to be relegated to the fringes of Europe like rival Turkey. And they want the government to crack down on tax evasion by the wealthy. "The Greek people are looking for blood," he says. They got a taste of it on May 17 when the deputy culture and tourism minister resigned amid allegations that her husband owed nearly $7 million in unpaid taxes and fines.

Greece leaving the euro "would lead to a sharp depreciation...[and] an almost immediate default"

The challenge for Greece is that budget cuts will deepen the recession and reduce the national income available to pay interest on its debt. Greece and other marginal members of the euro zone must also make structural reforms such as cutting red tape, reducing farm subsidies, and lowering barriers to entry in occupations such as law. Those crucial reforms are "really hard to monitor" and are proceeding more slowly, says Dartmouth's Papaioannou.

There are several ways this crisis could resolve itself. Harvard University economist Kenneth Rogoff says the EU should let countries like Greece step out of the euro zone temporarily, and get back in when they're ready. Or, instead of Greece dropping out, it could be Germany that gets fed up and ditches the common currency. Keat calls the prospect "unlikely" but concedes that "the political and economic logic is more interesting and compelling" than a Greek exit.

What is now clear is that a monetary union between countries with divergent fiscal policies is unsustainable. To make the single currency work, nations will have to give up more of their fiscal independence and meet stricter budgetary rules, with real penalties for noncompliance. Countries that can meet the new standard will have, for the first time, a durable currency. The challenge is to prove that all 16 nations that use the euro deserve to keep doing so.

—With Diane Brady, Rachel Layne, Maria Petrakis, James Pressley, and Chris Reiter



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Don't Cry for Argentina. The Worst May Be Over

▶ **Bank stocks are cheap, and political change is in the offing**

▶ **"Argentina is the least crowded trade in the world"**



Fernández de Kirchner is seeking an $18.3 billion debt swap from creditors

DIEGO GIUDICE/ARCHIVOLATINO/REDUX

Since defaulting on a record $95 billion of its debt in 2001, Argentina has been treated as a pariah state by the global capital markets. The husband-wife presidential tandem of Néstor Kirchner and Cristina Fernández de Kirchner have been criticized for nationalizing $30 billion in private pensions and raiding Argentina's central bank for $6.6 billion in reserves. Corruption and cronyism abound, as does harassment of businesses. Last year, Argentina got booted from the benchmark MSCI Emerging Markets index. A local stockbroker confesses that his country has a penchant for self-destruction—a record that he believes will continue.

Fair enough. It pays to forgive when investing in Latin America, however. In 2001, Colombia was nearly a failed state until staging a comeback that saw its stock market surge more than fifteenfold. In 1999, Brazil could not service its debt; today it's the region's juggernaut economy. Now Argentina is getting a second look by investors, who have bid up the Merval stock index by 163 percent since its credit-crisis low in November 2008. (The index is off 7 percent in 2010.)

Optimists see three bullish trends. For starters, the Kirchners fared poorly in last year's midterm election. (Cristina is currently president.

Argentina's Merval index: The Road Back



DATA: BLOOMBERG FINANCIAL MARKETS

Néstor ran the country from 2003 to 2007.) They are now trying to raise cash and mend fences ahead of the 2011 presidential election.

Argentina is also bidding to reenter the global debt markets, a precondition to increased foreign direct and portfolio investment. Another plus: With the global economy recovering and both China and Brazil white-hot, the export outlook for the country's cornucopia of agricultural goods is improved. Much of Argentina's 1.07 million square miles are fertile and within reach of ports on its long Atlantic seaboard. Meanwhile, the country's publicly traded banks, attractively valued compared with lenders in neighboring countries, are an investment opportunity.

Then there are the reopened negotiations between Buenos Aires and foreign creditors over an $18.3 billion debt swap—unfinished business from Argentina's 2001 debt default and subsequent battle with bondholders. A successful deal would allow Argentina to tap the liquidity and preferable rates of the sovereign debt market, says John Price, a Latin America expert with Kroll, Marsh & McLennan's risk consultancy. That would in turn attract big overseas institutional investors and companies. Standard & Poor's believes Argentine companies will issue $1 billion of bonds in the months following the swap. "The restructuring will be the catalyst to concentrate less on the hostile rhetoric and more on Argentina's exports and stock market," says Walter Molano, head of research at BCP Securities, an emerging-markets-focused bank.

Contrary to their old form, the Kirchners are now keen to see a deal happen. The unpopular government needs cash to mollify the restive masses and beat back the opposition. Already opposition legislators are fighting to wrest discretionary earmarking powers from President Fernández de Kirchner. Meanwhile, Argentina is once again fulfilling its role as a breadbasket (54 percent of its export income is agricultural). According to the Economist Intelligence Unit, gross agricultural production is slated to grow 15 percent this year, driven by buoyant demand for soybeans, grains, and beef.

For investors with cast-iron stomachs, there are opportunities to be had in the financial sector. Santiago Maggi, chief investment officer at Bulltick Capital Markets, an investment bank that specializes in Latin America, notes that Argentina's entire publicly traded bank industry, including **Banco Macro**, **Grupo Galicia**, and **BBVA Banco Francés**, can be had for some $5 billion—a figure that wouldn't buy you any of the major banks in smaller economies like Peru, Colombia, and Chile. The upshot, predicts Maggi, is that those who invest in listed Argentinian banks could make three to five times their money in the next three to five years. "Argentina," he says, "is the least crowded trade in the world." By the time most American fund managers come around to appreciating this, he warns, it will be too late.
—Roben Farzad

The bottom line *If Argentine voters oust the Peronists next year, a more investor-friendly regime could be ushered in.*

Quoted



"Humans can be extremely rational in ordinary circumstances. The minute you give them an MBA, though, they start using these forecasts and these financial tools in ways that contradict their own behavior."
—Nassim Taleb, author of *The Black Swan: The Impact of the Highly Improbable*



Osborne has promised a pain-packed emergency budget in June

U.K. Deficit

A Young Chancellor's Talk Worries Investors

- George Osborne compares Britain to Greece and promises swift cuts
- "He's lacked gravitas and world experience"

Just a few days after he became Britain's new Chancellor of the Exchequer, 38-year-old George Osborne reassured Britons that he and the ruling Conservative-Liberal Democrat coalition had a plan to contain the $233 billion budget deficit. He also warned that Britain faced a Greek-style meltdown unless the cuts went through. "Greece is a reminder of what happens when governments lack the willingness to act decisively," he said. The warning was meant to tell voters that the coming fiscal pain is necessary. It also was a swipe at Osborne's Labour Party predecessors for what he called "13 years of fiscal irresponsibility."

Many investors found the direct comparison with Greece inflammatory and unstatesmanlike. "The chancellor may be unaware how dangerous is the ground he is crossing," says Stephen J. Lewis, chief economist at Monument Securities, a London brokerage. "It is irresponsible of him to talk up the scale of the U.K.'s debt problems and to draw parallels with Greece—the election campaign is now over."

FROM TOP: OLI SCARFF/GETTY IMAGES; ANDREAS RENTZ/GETTY IMAGES

Osborne has given government departments until May 24 to cut $8.5 billion from their 2010 budgets, and he has promised a pain-packed emergency budget on June 22. At the same time, he wants to simplify and cut corporate taxes to help business. He suggested he won't raise taxes beyond what was planned by the outgoing Labour government.

Yet for all his decisive steps, investors still worry that Osborne, the youngest chancellor in more than a century, lacks the political and financial skills to guide the nation's finances. Osborne hurt the Tories' quest for a majority by pronouncing late last year that Britain faced a "decade of austerity." He was trying to signal that a Conservative government would not mortgage the nation's future by indulging in reckless Keynesian stimulus. Instead he scared off voters. These gaffes make those who work in London's financial district, known as the City, nervous. A poll taken in the City found its denizens would have preferred that Justice Secretary Ken Clarke, chancellor from 1993 to 1997, return to his old job.

Osborne is a survivor and a favorite of the new Prime Minister, David Cameron. Both attended Oxford, though a few years apart, and both belonged to the same upper-crust dining society, the Bullingdon Club, that has nurtured many careers in Tory politics. Cameron kept Osborne, who shares his vision of modernizing the party, by his side and charged him with coordinating the Conservative strategy in the recent election campaign. Despite the disappointing outcome, Osborne got the job he wanted. "By appointing Osborne as chancellor, Cameron has shown that nothing can be done to separate them," says Tim Bale, professor of politics at the University of Sussex.

The office of Chancellor has always been the second-most-powerful job in British politics. When Gordon Brown, the recently defeated Labour Prime Minister, served as chancellor, he made the Bank of England independent, kept Britain out of the euro zone, and oversaw the biggest expansion in state spending in Britain's postwar history.

Osborne will find it to harder to use that power since his job is to cut. He wants to shrink the budget deficit by more than half in the next four years and argues that tackling bloated costs in

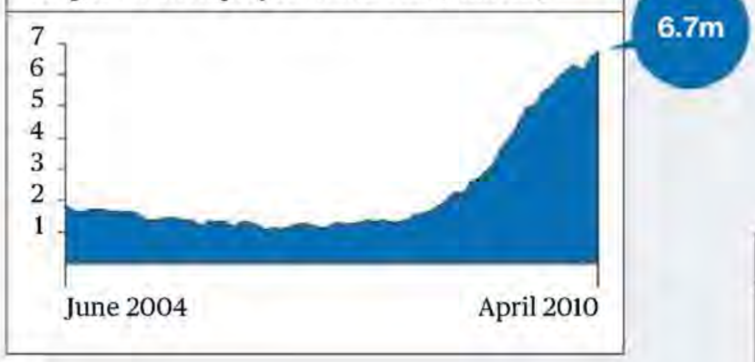
Workforce

The Long-Term Unemployed: A Guide

The number of those unemployed 27 weeks or more is approaching 7 million in the U.S. That's more than 45 percent of all jobless, a situation not seen since data began being compiled in 1948. The number is going up even as overall unemployment is starting to dip. While other countries, especially in Europe, have long struggled with the issue, the U.S. has few policies in place to deal with the long-term jobless, who get less employable the longer they lack a regular job.

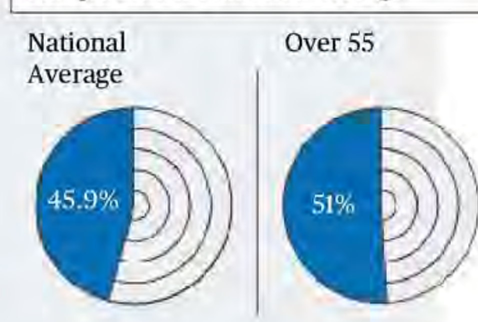
The numbers are mounting

Long-term unemployed in the U.S. (millions)



Older workers are suffering

Long-term unemployed as a share of all jobless older workers in the U.S., as compared with national average



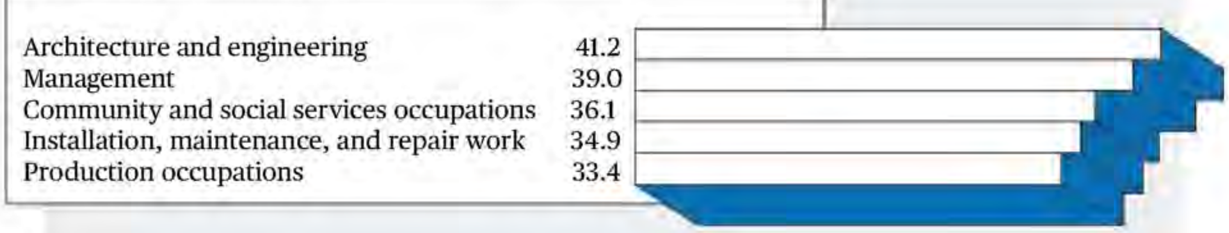
It's worse than before

Long-term unemployed as a share of entire U.S. labor force



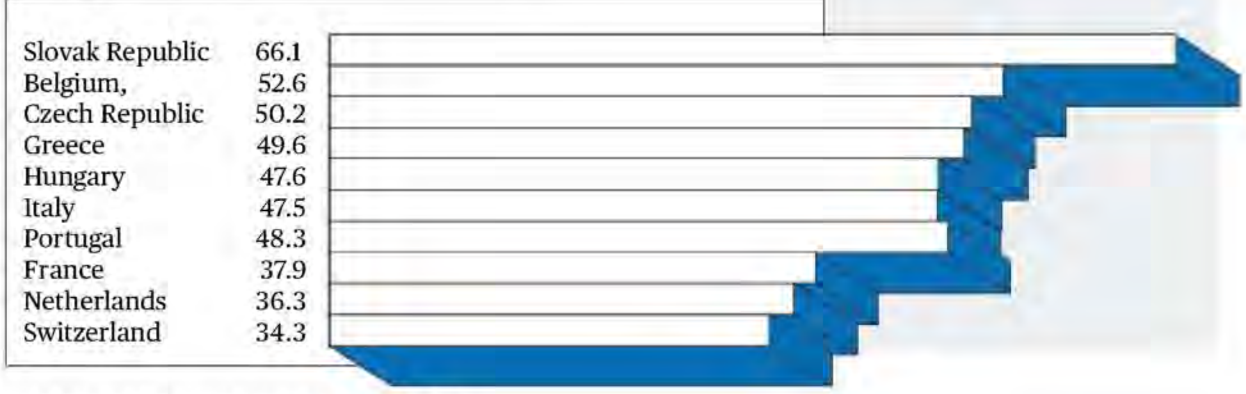
Many lines of work are hit

Long-term unemployed as a share of all jobless workers in different professions, 2009



Europe has it bad

Long-term unemployed as a percentage of total jobless, 2008



DATA: BUREAU OF LABOR STATISTICS, AARP, OECD



U.S. gun sales decline as fears of curbs fade page 21 ▶

the government will be far more effective than raising taxes. His room for maneuver, though, is limited: The health system, most of the military, and international aid programs are off-limits to the budget slashing.

Besides getting Britain on firmer financial ground, Osborne has to convince investors he's the man for the job. "He's lacked gravitas and world experience," says Bale of the University of Sussex. Osborne's budget speech on June 22 could win over the doubters–or confirm their fears. *—Gonzalo Vina*

The bottom line *Markets are jittery about Osborne's lack of experience. Quick, nonpartisan action would calm many investors.*

Investing

Chinese Savers Turn To Their Stockbrokers

▶ Equities are in, property and savings accounts are out

▶ "Even the bank staff advised me against depositing more money"

Ordinary Chinese investors are looking to stocks for a lift. If they're not careful, they may get the opposite.

Although the Shanghai Stock Exchange Composite Index is down more than 21 percent this year, Pan Weiting sees no better place to put her money. The 27-year-old Shanghai accountant recently shelved plans to buy an apartment after real estate prices reached record highs. The 2.25 percent interest she earns on the 400,000 yuan ($59,000) she has in her bank account is being nibbled away by rising inflation, which hit 2.8 percent in April.

If Pan were an American, she might switch to international stocks, gold, or municipal bonds. China's financial regulations, however, limit her investment choices to property or domestic equities. It's no contest. "The stock market is the best choice for the moment," says Pan. "Even the bank staff advised me against depositing more money."

Millions of other Chinese, who on average save half their income, share Pan's dilemma. Property prices are often out of their reach. If they do buy real estate, they risk seeing their investment wiped out should the government's recent curbs on mortgage loans finally chill the market. Inflation is forecast to climb 3.4 percent this year, according to the median estimate of 18 economists surveyed by Bloomberg on May 11. That will put more pressure on low-yielding savings accounts. "It becomes a question of who's the least ugly girl at the fair," says Victoria Mio, a Hong Kong-based senior fund manager at Robeco, whose firm manages $194 billion worldwide. "There is migration [to stocks] occurring, and the shift will accelerate with a few months of negative interest rates."

The softening of the real estate market could accelerate the trend. Citigroup of New York and Paris-based BNP Paribas predict a 20 percent drop in home prices in 2010. That's because Chinese policymakers have increased bank reserve requirements three times in the past three months to slow lending. As much as $59 billion, about a third of the housing transaction volumes in China's 35 biggest cities in 2009, may be diverted from property to equities this year, according to CITIC Securities, China's biggest listed brokerage.

The Shanghai market, though, has already given up all of its gains of the last 12 months, and it may give up far more before the year is out, costing Chinese stock players plenty. **BlackRock**, the New York mutual fund group, is selling Chinese stocks in expectation that economic growth has peaked, while State Street Global Advisors of Boston has an "underweight" on Chinese equities, as the shares are pricier than those of smaller developing nations. Despite its steep drop, the Shanghai index trades at 15.6 times estimated earnings, compared with a multiple of 12 for the MSCI Emerging Markets Index.

$7.2 Trillion

Combined personal and corporate savings in China

Yet even affluent Chinese keep heading for stocks. Logistics company owner Hu Jielin has spent $1.3 million buying apartments in Shanghai, where average home prices have risen threefold in the past five years. Hu, 33, says he won't buy more property, given the government's recently imposed clampdown on mortgages. Instead, he plans to double his stock investments in the next six months, to $439,000. "Property prices are probably going to take a breather," says Hu. "Currently, stocks look the best bet."
—Chua Kong Ho, Zhang Shidong, and Allen Wan in Shanghai

The bottom line *If Chinese savers stampede into stocks, share prices could rise for a while. But if the economy slows, stocks could drop sharply.*

Drawing Board



DRAWING BOARD: PETAR PISMESTROVIC/KLEINE ZEITUNG AUSTRIA/CAGLE CARTOONS; GUN: MIKE KEMP/RUBBERBALL/CORBIS; SAVINGS STATISTIC: THE WORLD BANK

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Global Economics

Renewable Power

For Solar, Storm Clouds From Greece

▶ Green energy producers suffer as governments cut support

▶ "The risk to subsidies is increasing... it's going to be painful"

As Europe grapples with the fallout from Greece's fiscal crisis, one early economic casualty is the renewable energy industry. Why? Few wind or solar installations would be profitable without subsidies, and as governments across Europe curb spending in response to the Greek crisis, support is being cut back. "The uncertainty in Europe is a further burden in a market that's still challenging," says Kathleen McGinty, a former adviser in the Clinton White House and a partner at private equity firm Element Partners in Radnor, Pa.

German lawmakers on May 6 slashed subsidies for new solar plants by as much as 16 percent. Italian solar industry groups expect support for new plants to be scaled back by as much as 25 percent in June. In Spain, power companies are bracing for cuts of 30 percent or more on new solar cell installations. Spain's government may also reduce its backing for existing solar producers, which had expected guaranteed prices for 25 years. Across the Continent, "the risk to subsidies is increasing," says Barclays Capital analyst Vishal Shah. "It's going to be painful."

For green energy companies based outside Europe, the pain is compounded by the falling euro. As the currency has dropped by 14 percent this year, profits on European sales have dwindled. **Canadian Solar**, a panel maker based in Ontario, took a $20 million charge for foreign-exchange losses in the first quarter and could see earnings fall 84 percent if the euro averages $1.25 this year, Barclays estimates. Profits for Chinese solar-cell maker **Yingli Green Energy Holding** would fall 42 percent with the euro at that level, while rival **Suntech Power Holdings** would see a 79 percent drop, Barclays says. Although using European suppliers has helped, says Suntech strategy chief Jerry Stokes, "the falling euro has been difficult to manage."

The troubles are taking a toll on stocks. Spanish turbine-maker **Gamesa Tecnológica**, which is laying off a tenth of its staff after sales slumped 43 percent in the first quarter, has seen its shares tumble 23 percent since Apr. 1. Canadian Solar's stock is down 50 percent in the same period, and Suntech is off by 35 percent. The 88-company WilderHill New Energy Global Innovation Index has fallen by 16 percent since Apr. 1, vs. a 10 percent decline for the MSCI World index.

Uncertainty about subsidies is making it harder for renewable companies to secure funding. **Renovalia Energy** and **Grupo T-Solar Global**, Spanish solar companies hoping to expand overseas, have delayed initial public offerings that together aimed to raise more than $500 million. **Solar Opportunities**, a Madrid-based investment company, has put off a $165 million purchase of a solar plant in northern Spain until the government sorts out how much it will spend to support the industry. For long-term investments such as renewable energy, says Solar Opportunities Chief Executive Officer Paul Turney, "business needs certainty." —*Ben Sills and Mark Scott*

The bottom line *The troubles that started in Greece are threatening subsidies in Europe needed to make green energy investments viable.*



At Infosys, employees have gotten hefty raises twice since October

NAMAS BHOJANI/BLOOMBERG/GETTY IMAGES

Outsourcing

Bangalore's Paying Again to Keep the Talent

▶ With recession over, wages shoot up—and workers start job-hopping

▶ "Having [IBM or Accenture] on your résumé definitely helps"

Before the global slowdown, software engineers employed by **Wipro**, **Infosys**, and other Bangalore outsourcers were switching jobs as often as three times a year to boost their pay and scamper up the management ladder. Only the deep freeze of recession put a stop to the turnover. During the worst days of the financial crisis, these Indian companies were overstocked with thousands of excess workers, and raises were suspended. "It was very scary," says Girish Paranjpe, joint chief executive officer of Wipro's IT business. "No one was going anywhere."

Now the industry's revolving door is spinning furiously once more. Infosys, **Tata Consultancy Services**, and Wipro reported robust first-quarter results. And right on cue, job churn rates have shot upward, with Wipro losing 17 per-


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cent of its employees, Infosys 19 percent, and **HCL Technologies** 22 percent in the January-to-March period, according to IIFL Research, which analyzes Indian markets. "There's a huge hunt for talent," says Paranjpe.

Companies are using hefty raises to stave off the high job turnover. Infosys offered employees in India pay increases of 8 percent last October and then an additional 14 percent to 17 percent in April. Workers at other shops are getting fatter paychecks, too. "I got a 50 percent raise," says Vishal Shah, 25, a business analyst at the Pune (India) office of **Cognizant,** the U.S. IT services company. Shah got his raise by landing a new assignment inside the company. "Even people who got promoted without a change in [career] track got as much as a 40 percent raise," he adds.

The major Western consulting companies are adding to the turnover at their Indian competitors, as **IBM**, **Capgemini**, and **Accenture** all plan to strengthen their operations in India. Accenture, for instance, is expected to have 50,000 employees in the country by the end of 2010. For someone looking to advance in the industry, says Vijay Gautam, an analyst in Mumbai with Jaypee Capital Services, "having a Western company on your résumé definitely helps."

The problem with high turnover is not just the higher costs that come with big pay raises. The average pay for an IT worker in India is still $20,000, compared with as much as $85,000 for his or her counterpart in the West.

The real challenge is maintaining the quality of the workforce, as companies lose veteran workers in droves while at the same time hiring tens of thousands of new employees. Supercharged turnover taxes the ability of the Bangalore companies to train workers fully, promote only the most deserving candidates, and keep corporate clients satisfied. That's especially important since a surge in demand for outsourcing services is expected when the U.S. health-care system gets overhauled and Wall Street prepares to comply with new financial regulations. For Bangalore, these are good headaches to have, but headaches nonetheless.

—Bruce Einhorn with Ketaki Gokhale

The bottom line *As recession fades, salaries are rising fast again in India's IT sector. High turnover will complicate efforts to keep staff quality high.*

Consumer Spending

Despite a Tax Cut, Food In France Is Still Pricey



▶ A lower VAT slows restaurant defaults, but *l'addition* barely budges

By now, French restaurantgoers were supposed to be enjoying cheaper ratatouille and *boeuf bourguignon*. After restaurant bankruptcies soared in 2008, the French government last July reduced the value-added tax on dining to 5.5 percent from 19.6 percent. In return, restaurateurs promised to lower prices by about 3 percent.

Government statisticians, though, say the typical restaurant tab has declined only 1.17 percent since the cut took effect. "Honestly, I haven't noticed any difference," says Albert Delbes, sipping coffee at Le Royal Trinité, a café near the Saint Lazare train station in Paris. Like many eateries, the café has trimmed prices on a handful of items—a plate of *moules frites* is now $17.20, down from $18.50—while leaving most unchanged. Especially for smaller restaurants, "it's very difficult ... to lower prices when the cost of ingredients keeps going up," says Gérard Guy, head of a national association of independent restaurateurs.

Restaurants have made good on another pledge. They promised to use some of the $3 billion in annual VAT savings to hire workers, raise salaries, and invest in job training. The industry has added more than 5,300 jobs since last summer even as French unemployment rose, and restaurant salaries are up an average 5 percent. Tourism Secretary Hervé Novelli, who negotiated the tax cut, said on May 5 he's generally satisfied with those results, despite the skimpy price reductions. Ⓑ *—Carol Matlack*

The bottom line *A tax cut for restaurants in France didn't do much to lower prices. It has helped create jobs and stem a rise in bankruptcies.*

Tom Keene's EconoChat

Tom talks with former Federal Reserve Chairman Paul Volcker about Europe, currencies, and financial reform in the U.S.

What do they have to do in Europe now?
What they've got to do is make a big adjustment. They somehow have got to get the economy moving more strongly in an environment where they can't change the [currency], and they can't change interest rates, which are already low. That is a long, difficult process.

BNP Paribas talks about parity with the euro by 2011. UBS indicates sterling at $1.05. Will weaker currencies give Europe a chance to escape tough decisions?
No. That's the road to inflation and instability.

Let's go domestic. Are you happy with the financial reform bill in the Senate?
I am reasonably happy with it. There are several key provisions that I strongly support.

Which ones, please?
Well, the big problem is the question of "too big to fail." And this bill [tries] to deal with that through what is called a resolution authority. We [arrange] for the government to take over a really significant, failing financial institution much more promptly and arrange what I like to think of as a decent burial. That means they have to be careful at meeting the immediate obligations of that institution, but the authority will facilitate either mergers of parts of it, or a dissolution, or a wind-up of the institution. And that should be done without any feeling of an alternative.



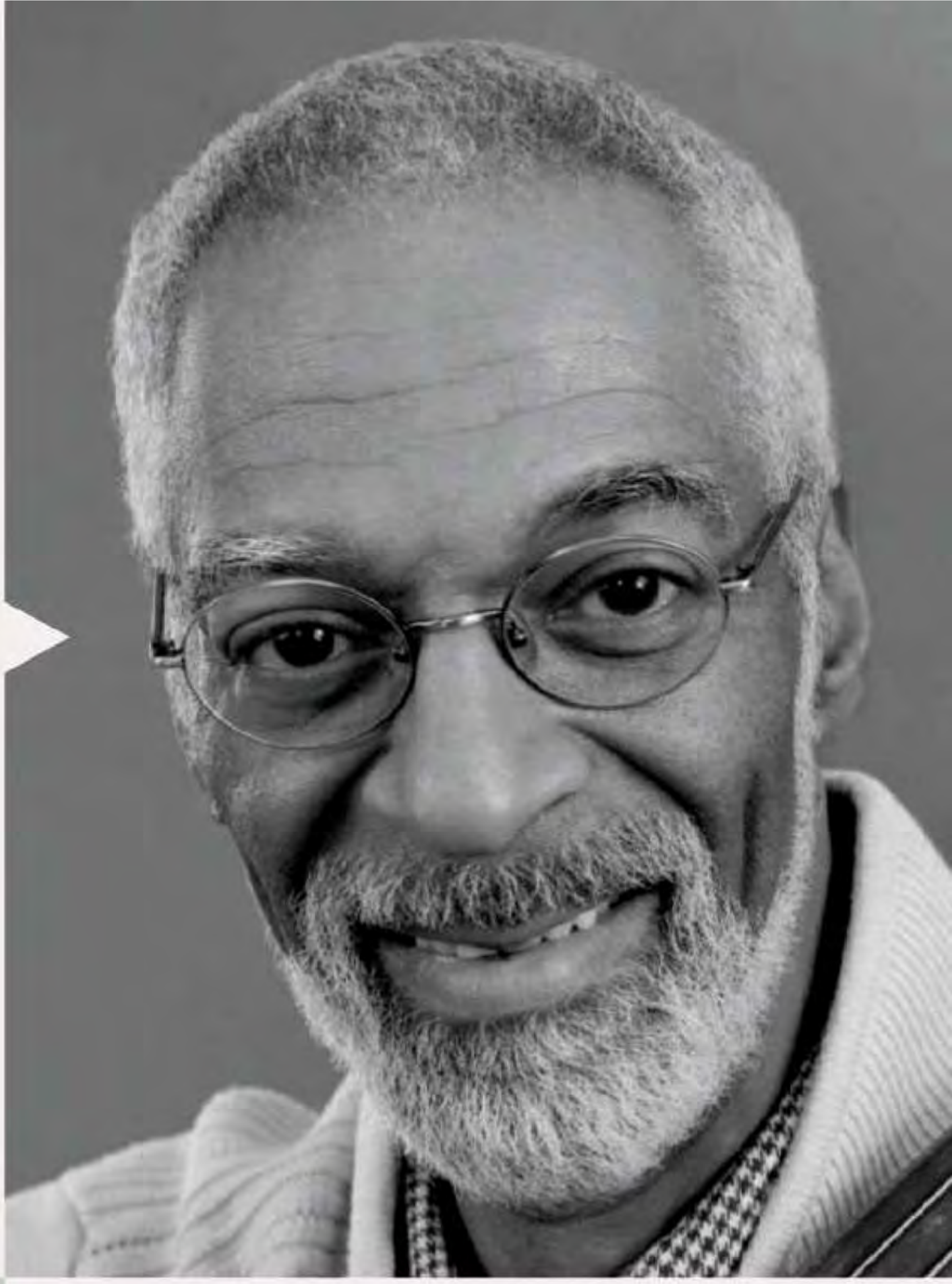
Keene hosts Bloomberg Surveillance 7-10 a.m., *1130AM in New York, XM129, Sirius 130.*

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At Subaru, Sharing the Love Is a Market Strategy



ILLUSTRATION BY STEPHEN KRONINGER

▶ **The quirky car brand barreled through the recession**

▶ **"They're kind of the poor man's Audi"**

While much of the U.S. auto business is just beginning to emerge from retrenchment mode, sales at Subaru of Glendale are climbing every month—and owner Sam Ershadi is even considering expanding his California dealership. "Our customers were not affected by the recession," he says. "They have a better financial situation."

By courting financially solid buyers with a taste for the quirky, tiny **Subaru of America** sped through 2009, logging record sales and market share along the way. Last year Subaru became the 11th most popular U.S. auto brand, up from No. 19 just a year earlier. Record sales in cities like Los Angeles, Atlanta, Dallas, and Orlando helped make Subaru the fastest-growing mass-market car brand in the U.S. for the last two years. It's the growth leader again so far in 2010—up 41 percent through April. For the first time, its unit sales exceed those of such better-known brands as **BMW**, **Lexus**, **Mazda**, and **Volkswagen**.

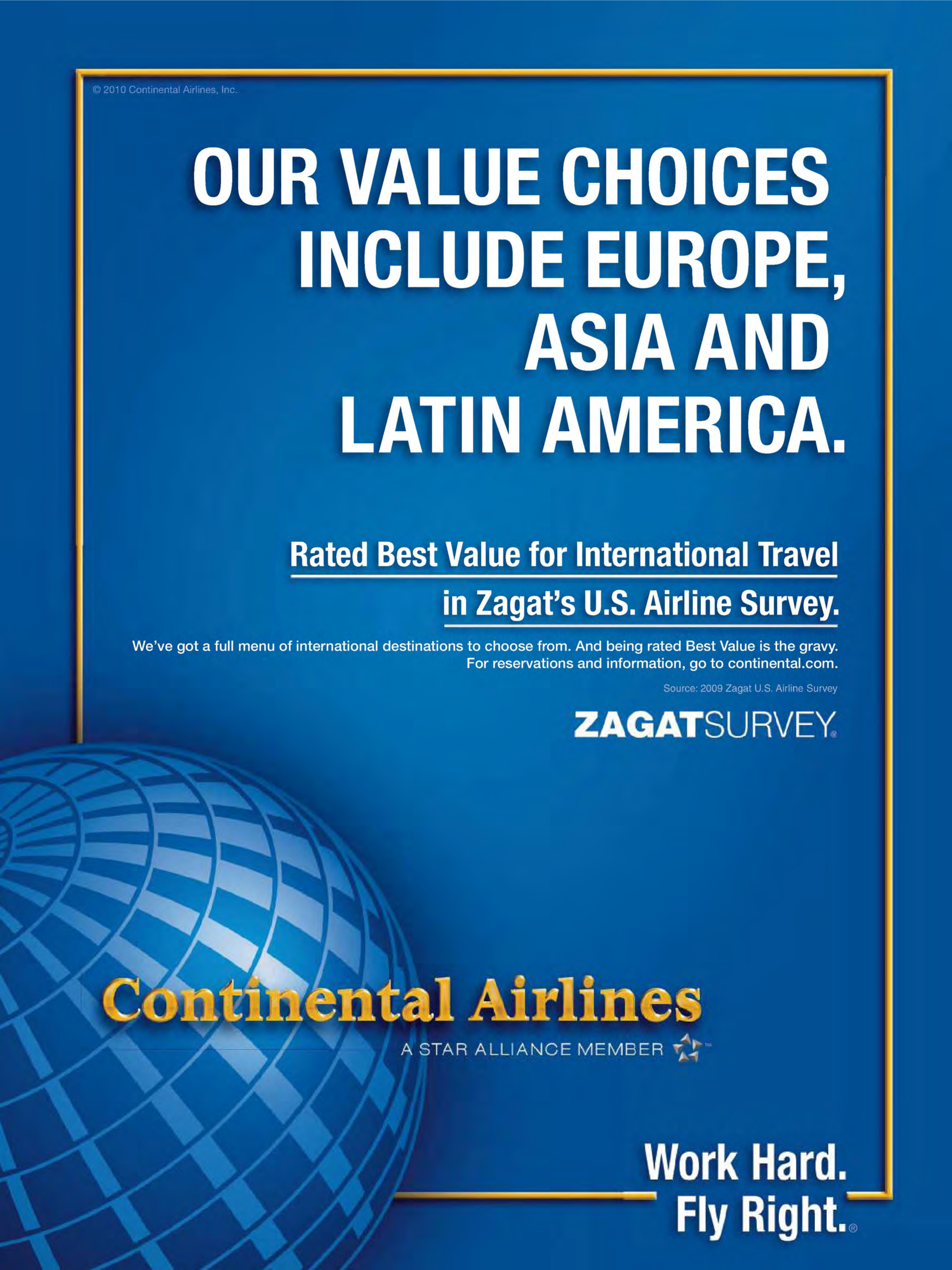
Subaru, the auto unit of Japan's **Fuji Heavy Industries**, has long been popular with a core of professorial drivers in tweed in the Northeast and flannel-clad outdoor enthusiasts in the Northwest. Lately, however, the carmaker has been aggressively moving beyond the snowy, soggy, and mountainous regions that are its stronghold. "People have been finding out about them outside of New England," says Rebecca Lindland, an analyst at IHS Global Insight in Lexington, Mass. "They are quietly successful, and their buyers appreciate that. They haven't abandoned their core."

Subaru's secret is that it understands the customers who drive its cars and has gotten smarter and more aggressive about reaching out to new ones who would feel at home as part of that clan. The company has the type of customer base that's particularly attractive to carmakers. The average household income of a Subaru owner is $88,000, the same as **Honda Motor** and $10,000 more than **Toyota**, says Alexander Edwards, president of market researcher Strategic Vision. Plus, Subaru buyers are three years younger than the industry average and a quarter more likely to have a college degree.

They are a thrifty lot, traditionally buying less car than they can afford. Some 36 percent pay cash. Subaru has played to that frugal bent by cutting roughly $1,200 from the $26,342 average price of its cars in 2007. Those cuts haven't killed profit margins because the lower prices allowed Subaru to reduce sales incentives and rebates on its cars substantially. Currently, the company gives about $1,333 per vehicle in incentives—the lowest level of any major car brand, says Thomas Doll, chief operating officer. That's almost half the $2,310 in incentives Toyota currently gives its buyers.

Much of the automaker's marketing focuses on cementing its connection to customers. Subaru's research shows them to be an eco-friendly bunch who value the freedom to go where they want, when they want. Unlike luxury car buyers, Subaruers are "customers who are not buying things, but experiences," says Chief Marketing Officer Tim Mahoney. That meshes nicely with Subaru's all-four-wheel-drive lineup, showcased by TV ads that star one of its cars caked with road grit, being applauded by admiring spectators on a suburban Main Street. The tagline: love. "In their marketing they've been focusing on what creates love between the owner and the automobile," says Edwards. "The 'share the love' campaign has been effective. They play up fun, the adventure you can have in a Subaru."

Last year the company sold a


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Sheila Bair: Second fiddle to the Fed? page 28 ▶

record 216,652 cars in the U.S., including the Legacy sedan and the Forester and Outback sport-utility vehicles. It's upping production 40 percent this year at its Indiana plant, which also builds cars for Toyota, Fuji's largest shareholder. The plant is located in an official wildlife preserve with no waste sent to landfills, in keeping with Subaru's support for causes such as the American Canoe Assn. and the Leave No Trace Center for Outdoor Ethics.

Such brand-building moves help Subaru win new customers on the cheap. It spends about $154 million a year on U.S. advertising–$100 million less than the Volkswagen brand (which sells about the same number of vehicles in the U.S.), a fifth of what **Hyundai** spends, and a fraction of the $2.2 billion plunked down by **General Motors**, the industry spending leader, according to Kantar Media. "They're kind of the poor man's Audi," says James Bell, executive market analyst for Kelley Blue Book in Irvine, Calif.

To keep growing, Subaru would benefit from adding a compact-class car and hybrid to its U.S. line, says Bell. Subaru and Toyota have said they're working together to develop a small, sporty car that both will sell. Fuji Heavy President Ikuo Mori has said the company's first hybrid will arrive in 2012.

One thing won't change: Subaru's emphasis on the relatively upscale buyer who values freedom and frugality. Subaru managers think that's a market of up to 60 million buyers–far larger than the niches of academics, tree huggers, and gays and lesbians that it's long been associated with.

"They are basically adding people who are Subaru buyers in their hearts, but don't know it," says Edwards of Strategic Vision. By Subaru's math, with 2.4 million Subarus now on the road, that leaves 57.6 million customers to go. *—Jeff Green and Alan Ohnsman*

***The bottom line** By maintaining the quirky persona of its brand and keeping prices low, Subaru has quietly, but aggressively, increased growth.*

Energy

The Race for Reactors As Small As a Fridge

▶ Pint-sized nukes could generate power for small towns or plants

▶ "You still have to have guards and dogs"

When most people think of nuclear power plants, visions of huge complexes like Three Mile Island come to mind. Now companies are rushing to develop a new generation of refrigerator-size nuclear reactors to help meet the world's growing demand for electricity.

John Deal, chief executive officer of **Hyperion Power Generation**, intends to apply for a license "within a year" for units that would power a small factory or towns too remote to be connected to traditional electricity grids. The Santa Fe-based company, as well as Japan's **Toshiba**, are vying for a head start over traditional reactor makers **General Electric** and **Areva** in downsizing nuclear technology.

"We're building iPhones when the nuclear industry has traditionally built mainframe computers," says Deal. Hyperion says it has more than 150 purchase commitments from customers, including mining and telecom companies, provided its technology gets licensed for operation by the U.S. government.

A generation after the Chernobyl and Three Mile Island accidents wiped reactor construction off the agenda of many governments, developers are pressing ahead with designs to satisfy demand for power that doesn't pollute. World electricity demand is forecast to grow 2.7 percent annually until 2015 and then 2.4 percent annually until 2030, according to estimates by the International Energy Agency.

While large-scale nuclear plants now under way cost an average of $6.2 billion and will generate multiple gigawatts of power, Hyperion's price tag is $50 million for a 25-megawatt reactor, more comparable in cost to diesel generators or wind farms. Transportable by truck, the units would come in a sealed box and require less maintenance than a fossil fuel plant. Developers say they'd cost 15 percent less per megawatt of capacity than the full-scale atomic reactors now on the drawing board, according to World Nuclear Assn. data. "A 25Mw plant would put electricity into 20,000 homes, and it would fit inside this room," says James Kohlhaas, vice-president at a **Lockheed Martin** unit that builds power systems for remote military bases. "It's a pretty elegant microgrid solution."

So far, no manufacturer has sought certification for any small reactor, according to the Nuclear Regulatory Commission. Formal approvals would likely take three to five years, the same as for bigger reactors, says Scott Burnell, a commission spokesman.

Environmentalists are concerned that small reactors would pose the

Drawing Board



Blame Slick

same risk of leaking radioactive materials as their larger counterparts, says Jan Beránek, nuclear energy project leader at Greenpeace International in Amsterdam. "Terrorists could hijack a reactor and directly use it to cause a meltdown or use it to fabricate fissile materials for later use in a weapon," Beránek says.

Deal rejects those concerns, noting that his units are designed to fit in the same canisters used to transport nuclear fuel for bigger plants. The power-producing core ships in multiple sealed chambers, containing any leak, and the entire unit would be installed in an underground vault to protect it from tampering and natural threats, Hyperion says. "You still have to have guards and dogs, but you have to do that with a grocery store in some countries," says Deal.



Hyperion's power module could supply 20,000 homes and fit in a room

The basic technology used by Hyperion was invented a half-century ago at the government's Los Alamos National Laboratory in New Mexico. Six other mini-reactors are being planned by companies including **NuScale Power**, Toshiba, and **Westinghouse**, acquired by Toshiba in 2006. Westinghouse has been developing tiny reactors since 1999, intended for sale to small industry, utilities, and customers in developing nations, says Michael Anness, manager of its Advanced Reactors, Research & Technology Div. Toshiba is working on reactors that would produce 10Mw and 50Mw, called 4S, for "supersafe, small, and simple." It will apply later this year for U.S. approval to test a unit in the village of Galena in central Alaska, says spokesman Keisuke Ohmori.

Galena has no connection to power lines and is closed to barge traffic for more than half the year while the Yukon River is frozen. To provide heat and electricity, the town has always relied on diesel fuel, which has risen in price by about 48 percent in the past 12 months.

—Jeremy van Loon and Alex Morales

The bottom line *Small nuclear reactors hold much promise. Overcoming opposition to get operating permits will be tough.*

OPPOSITE PAGE: ANDREW HARRER/BLOOMBERG; ILLUSTRATION BY RJ MATSON/THE ST. LOUIS POST DISPATCH/CAGLE CARTOON; THIS PAGE: CHRIS KEANE/REUTERS



The NRA annual meeting in Charlotte: Gun foes have been relatively quiet

Weapons Industry

Gun Sales Decline As Fear of Curbs Fades

▶ Demand falters as Democrats steer clear of the volatile issue

▶ "If they thought they could get away with it, they would ban guns"

The firearm industry marches to its own drummer. It thrives when manufacturers and retailers—together with the voluble National Rifle Assn.—convince heat-inclined consumers that tougher gun control is on the way.

That paradox of declining gun sales in an era of relative gun friendliness was on display at the NRA's annual meeting in Charlotte, N.C., on May 14-16. Keynote speaker Sarah Palin, during a raucous sold-out rally at the Time Warner Cable Arena, tried to stoke fears of regulatory oppression. Still, she conceded that President Barack Obama and his allies have avoided the gun issue.

"If they thought they could get away with it, they would ban guns and ammunition and gut the Second Amendment," Palin said. Instead, Obama has taken flak from anti-gun activists for refusing to spend any political capital on firearms.

Gun and ammunition sales grew 8.9 percent in 2009 to $10.4 billion, reports research firm IBISWorld. Some of that growth came from huge military ammo buys to supply troops in Iraq and Afghanistan. A lot of it, however, reflected the purchase of guns and bullets by consumers who feared Obama would restrict sales later. This year, with anxiety over gun control easing, the industry will experience a 5.7 percent revenue decline, figures IBISWorld.

Still, the outlook isn't entirely bleak for gunmakers and sellers. From 2011 to 2015, the industry will grow at an annual rate of 3.7 percent, IBISWorld analyst Nima Samadi predicts. That's down from an estimated annual pace of 6.9 percent for the five-year period ending Dec. 31, 2010. *—Paul M. Barrett*

The bottom line *Even as industry revenue levels recede this year, there's potential for modest growth through 2015.*

Legal Affairs

Big Tobacco Gets Its Many Days in Court

▶ Facing thousands of lawsuits in Florida, cigarette makers cry foul

▶ "These cases are the greatest litigation threat" to the industry

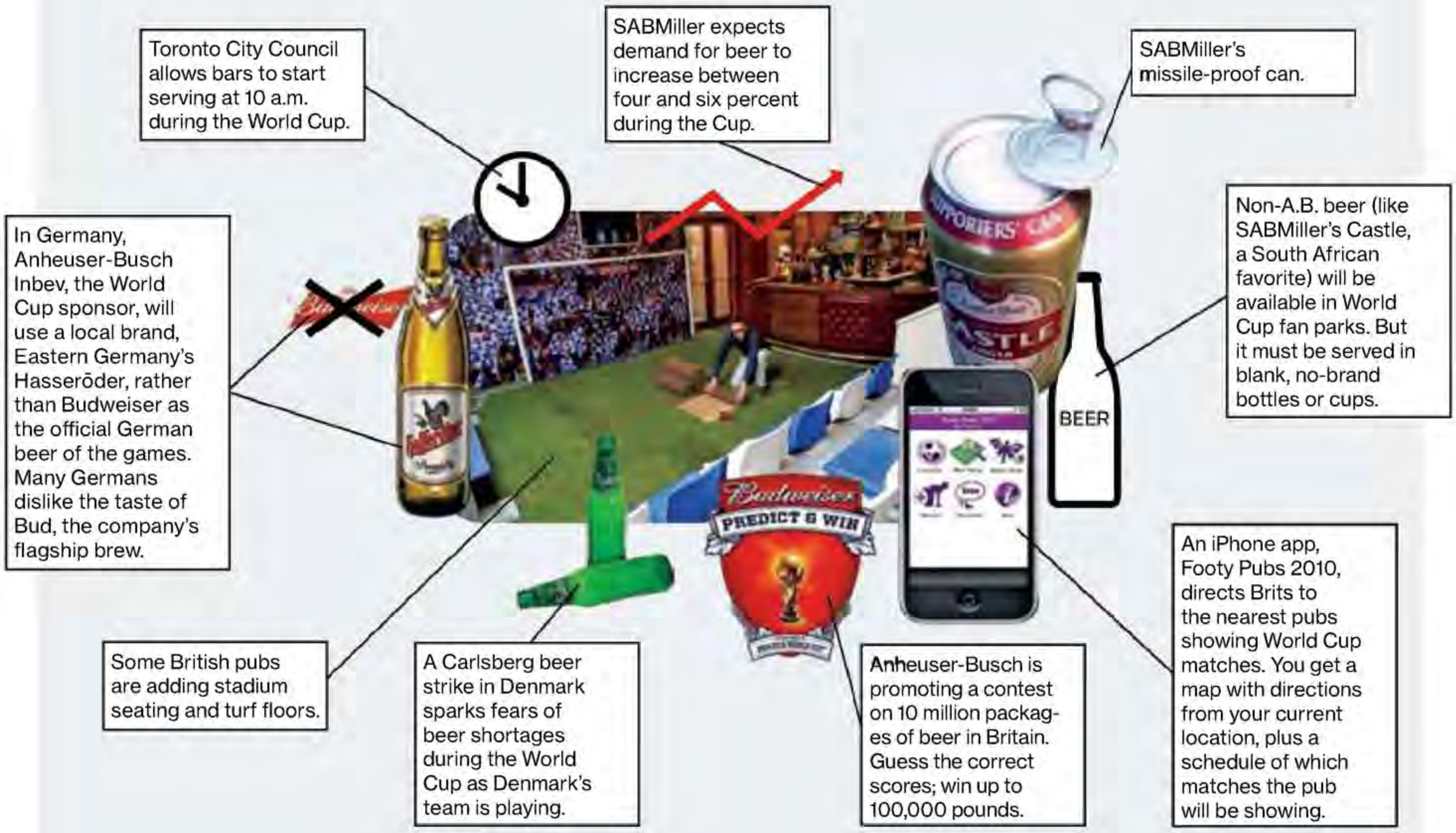
U.S. cigarette makers, led by **Altria Group** and **Reynolds American**, have racked up a dismal record in Florida courts, where smokers and their families won 14 of the last 15 trials and were awarded more than $200 mil-

Companies&Industries

Beverages

Where There's Soccer, You Can Bet There's Going to be Beer

The World Cup, to be played in South Africa starting June 11, is expected to boost beer drinking worldwide. From a pub-hunting iPhone app to a beer can that's less likely to be hurled at the other team (it's refillable), here are some suds-related developments that could be game-changers:



lion in damages. But plenty of battles remain. That's because there are still more than 9,000 claims left to be tried.

The industry's string of 14 losses, followed by one victory on May 19, are among the first cases to be heard on behalf of sick and dead smokers since the Florida Supreme Court threw out a huge class action aiming to represent 700,000 smokers in 2006. The suit claimed tobacco companies misled smokers about the addictive nature of smoking and its impact on health. The state high court, which in the same ruling gave Big Tobacco a victory by striking down a $145 billion punitive damage verdict against the industry, said individuals in the disallowed class could instead sue on their own. That set off a rush of lawsuits that has left a cloud over tobacco companies' finances, although few expect the individual judgments to approach the class action's $145 billion.

"Collectively, these cases are the single greatest litigation threat facing the industry," says Morgan Stanley analyst David Adelman.

Lawyers for Florida smokers say they hope the early verdicts will spur tobacco companies to settle remaining claims. Defense lawyers, however, argue the losing streak shows that the ground rules applied in the trials make it impossible for the companies to get a fair hearing.

About 5,000 smokers' claims are filed in Florida state courts, where the industry has won 3 verdicts and lost 15 since February 2009. Some 4,400 more are pending in federal courts in Florida.

The cases stem from a class action filed in 1994 and litigated for 12 years in the Florida court system. That case was brought by Howard Engle, a Miami pediatrician who died last year at age 89.

As part of its 2006 decision ending the case, the state Supreme Court gave members of the disallowed class a year to file individual claims and said they can use some of the jury findings of a 2000 trial in their cases. Among those findings are that tobacco companies sold defective products, concealed dangers of smoking, and acted negligently.

The federal cases are on hold while the U.S. Court of Appeals in Atlanta considers a challenge to the applica-

IAN GAVAN/SKY/GETTY IMAGES (PUB);SABMILLER/BLOOMBERG (CASTLE BEER); OPPOSITE PAGE FROM TOP: JEFF WATTS/AMERICAN UNIVERSITY; MARY KNOX MERRILL/NORTHEASTERN UNIVERSITY; STEPHEN SARTORI/SYRACUSE UNIVERSITY; DANIEL ACKER/BLOOMBERG

tion of the 2000 jury findings. The epicenter of the post-Engle litigation, for now, is the Fort Lauderdale courtroom of Circuit Judge Jeffrey E. Streitfeld. A 19-year veteran of the Florida bench, Streitfeld has tried eight smoking cases to verdict in the past two years, more than any other judge in the country.

Under a two-stage trial plan used by Streitfeld, jurors are first asked to decide whether the plaintiff was a member of the disallowed Engle class—that is, whether the smoker's illness was caused by addiction to smoking. If the jurors find the plaintiff to be in that group, they move to the next phase to consider whether the tobacco companies are at fault and, if so, what damages they should pay. During the second phase, Streitfeld reads jurors the factual findings upheld by the court in the Engle case.

Tobacco industry lawyers claim that this arrangement means smokers no longer have to prove that specific wrongdoing by cigarette companies actually caused their injuries. They say that violates Florida law and the companies' right to a fair trial. "It is a due process violation of the most basic sort," says Murray Garnick, senior vice-president and associate general counsel for Altria.

Edward Sweda, senior staff attorney for the Tobacco Products Liability Project, an antismoking group, says he thinks the Florida trial procedures are fair, and that the 9,000-plus people bringing claims now are a fraction of the estimated 700,000 Engle class plaintiffs.

Both sides agree it could take decades for the cases to wind their way through Florida's legal system. Streitfeld says the 350 cases pending in his court alone may take more than 20 years to try. That's unwelcome news for many plaintiffs. Said Streitfeld in an interview: "There's no way all these cases can be reasonably tried in our lifetimes." *—Bob Van Voris*

The bottom line *More than a decade after state governments and tobacco companies reached a master settlement, private suits are being litigated.*

-1.4

PERCENT

Decline in U.S. sales at Wal-Mart Stores (open at least a year) during the first quarter of 2010

DATA: BLOOMBERG

Consumer Products

A Root-to-End Makeover for Pantene

▶ **Procter & Gamble's biggest beauty brand gets an overhaul**

▶ **"It's a way to try to win back the hearts of their consumers"**

What does a woman do when her do starts to look tired? Cut off split ends, switch conditioners, maybe try a little color. That's pretty much what **Procter & Gamble** is doing with Pantene, the market leader in hair care, with some $3 billion a year in sales. The health and beauty giant tapped 17 PhDs and technologies usually reserved for space and medical research to overhaul the brand. The results of the more than two-year effort started showing up on store shelves this month. "It took going beyond what was really common to hair-care research to look for different ways to understand what was at the root of the problem," says Jeni Thomas, a senior scientist at P&G's beauty research facility north of Cincinnati.

The company is hoping the third revamp since 1999 of its biggest beauty brand will restore sales in the U.S., where competition from cheaper rivals—including private-label alternatives—has intensified with the recession. Two-thirds of Pantene shampoo varieties saw sales declines in the 52-week period ended Apr. 18, according to Sym-

Quoted on Campus

It's college commencement time, and CEOs are doling out advice



Vikram Pandit
CEO of Citigroup

Columbia University, May 17
"Americans have the right to be angry about the financial crisis. People should question the financial system and those who run it.... We cannot live without the financial system, but we do not have to accept its excesses."



Kenneth I. Chenault
Chairman and CEO of American Express

Northeastern University, May 7
"In exchange for ... permission to pursue profits, business must behave and act in ways that protect and enhance the world we live in.... You can't just look at the bottom line."



Seth Goldman
Co-founder, president, and CEO of Honest Tea

American University, May 8
"Be the tea.... You may not be the sweetest or cheapest tea ... or the one with the flashiest label. But ... if you believe in what you're doing, you'll be more effective, more passionate, and more authentic in everything you do."



Jamie Dimon
CEO of JPMorgan Chase

Syracuse University, May 16
"More than any previous generation, you have been tested and shaped by unrelenting change.... The opportunities that you'll create ... may not yet be evident.... But you will change the world for the better. Of this I am sure."

phonyIRI Group, a Chicago-based research firm. P&G, like other big consumer-products companies, also has been under pressure from big-box retailers and drugstore chains that are trying to cut down on brand clutter. "You'd go to **CVS** or **Wal-Mart** and the whole shelf would be Pantene," says Ali Dibadj, an analyst with Sanford C. Bernstein. "They added more and more products that confused the consumer."

As part of the relaunch, P&G reduced the number of shampoos, conditioners, and styling aids by close to one-third, to around 116 products. The entire line has been reorganized around four specific hair types–color-treated, curly, fine, and medium-to-thick–and color-coded to make selections easier for shoppers. Computer modeling allows P&G to predict the performance of millions of shampoo and conditioner prototypes without having to develop them. Still, 600 formulas were tested on more than 20,000 women worldwide. An atomic force microscope, similar to one used on NASA's Phoenix Mars Lander, and microcomputed tomography, used to measure bone density, helped reveal how ingredients interact with different hair types. "Research showed us a lot of ways to innovate in the category that quite frankly was needing some innovation," says Julie Marchant-Houle, P&G's North America marketing director for retail hair care.

It wasn't always this complicated. As recently as the 1960s, shampoo was essentially soap, and people used oil to add softness and sheen. Nowadays a bottle of shampoo carries about a dozen ingredients. Pantene's reformulated potions include 13 substances P&G has never used before, including polymers developed in partnership with university labs and other research institutions, says Thomas, who like Marchant-Houle sports a mane as shiny and smooth as the models in Pantene's TV ads.

For now, the revamped Pantene line will be available only in North America. Although previous overhauls were accompanied by price increases, P&G is holding the price steady this time, at around $4 per bottle. "It's a way to try to win back the hearts of their consumers," says Jason Gere, an analyst with RBC Capital Markets. — *Mark Clothier*

***The bottom line** P&G is counting on a reconfigured Pantene lineup to beat back competition from hair-care upstarts and private-label brands.*

In brief



To spur U.S. sales, Wal-Mart plans to cut prices even more this summer

Wal-Mart Stores
Sales Fall at Home, Surge Abroad
On May 18, Wal-Mart said profits were up 10 percent in the first quarter, to $3.32 billion, powered by an 8.9 percent jump in international sales. That was the good news. The bad: Sales at U.S. stores open at least a year fell 1.4 percent during the period, more than anticipated. The world's largest retailer said the summer months will bring additional price reductions on items at U.S. stores, including cereal, ice cream, and laundry detergent. Price cuts by Wal-Mart and other big-box retailers may have contributed to an unexpected 0.1% decline in consumer prices in April, the first drop in more than a year.

Samsung Electronics
The Korean Company Is Outspending Rivals
Samsung Electronics' record $15.6 billion capital-spending plan for 2010 may widen its lead in the memory chip and flat-screen industries to the extent that rivals won't be able to catch up, some analysts say. The South Korean company will plow the lion's share of the money into semiconductors, where it wants to boost capacity. Liquid-crystal displays for TVs and mobile phones are other priorities. Samsung's investment budget is the largest in the tech industry, topping those of Intel, IBM, and Sony combined.



Pfizer
Scaling Down For 2011
Pfizer will close eight plants and scale back operations at six other sites worldwide, eliminating 6,000 jobs over the next five years. The facilities being padlocked are in Puerto Rico, Ireland, and Rouses Point, N.Y. The job cuts are part of more than 19,000 positions Pfizer said it would eliminate following its $68 billion acquisition last year of Wyeth. The drugmaker is bracing for a tough 2011, a year in which its top-selling Lipitor cholesterol pill, which has annual revenues of $11 billion, will lose patent protection.

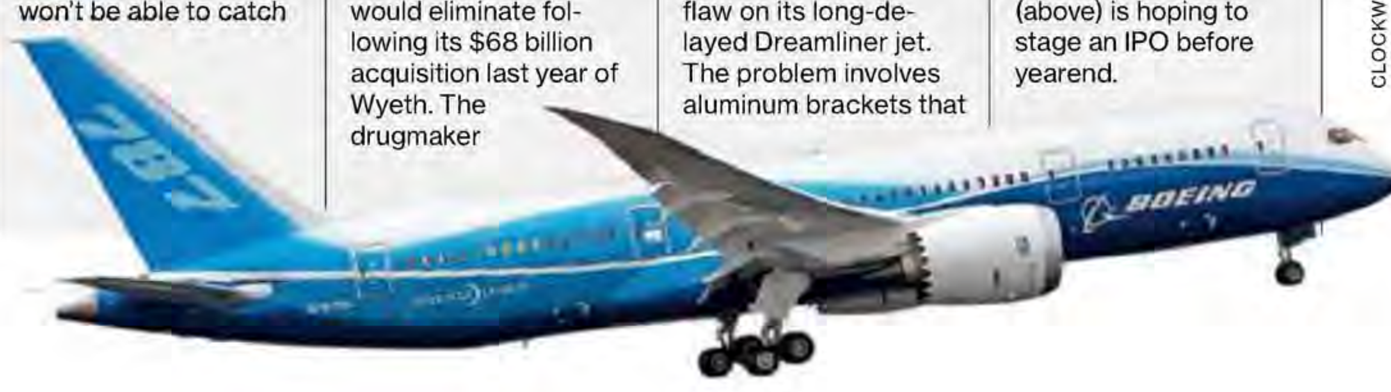
Occidental Petroleum
Leading a Rush Back To Onshore
In a May 19 presentation, Occidental Petroleum doubled its estimate for a discovery near Bakersfield, Calif., to the equivalent of as much as 500 million barrels of oil, which would have a value of more than $34 billion at current prices. The Los Angeles-based company bucked the oil industry migration to deep-sea drilling during the past decade and focused on onshore fields from Texas to Abu Dhabi. Some rivals may be tempted to follow suit as BP's Gulf of Mexico disaster is likely to spur tougher rules for offshore drilling.

Boeing
More Loose Ends on The Dreamliner
Boeing on May 17 revealed it had uncovered another design flaw on its long-delayed Dreamliner jet. The problem involves aluminum brackets that attach sections of the fuselage to the skin of the plane. Boeing has struggled with its new system of using suppliers to design and build the plane around the world, and then sending large sections to be snapped together at its main factory in Everett, Wash. The company says repairs won't further delay the Dreamliner's entry into service, which is already more than two years behind schedule.

Google
Android Is Racking Up Share in Smartphones
A May 19 report from Gartner showed strong gains for the Google Android mobile operating system amid a 49 percent jump in smartphone sales worldwide in the first quarter. Google's Android software leapt past Microsoft's Windows Mobile and Linux to run almost 10 percent of all smartphones shipped during the first three months of the year, up from just 1.6 percent in the comparable period of 2009.



General Motors
Back in The Black For the First Quarter
On May 17, General Motors reported net income of $865 million for the first quarter, its first quarterly profit since 2007. Rising production and smaller discounts pushed revenue up 40 percent from the same period last year, to $31.5 billion. GM filed for protection from creditors last June and emerged from bankruptcy in July. Chairman and CEO Ed Whitacre (above) is hoping to stage an IPO before yearend.



CLOCKWISE FROM TOP: DANIEL ACKER/BLOOMBERG/GETTY IMAGES; JEFF KOWALSKY/BLOOMBERG/GETTY IMAGES; KEVIN P. CASEY/BLOOMBERG/GETTY IMAGES; HARUYOSHI YAMAGUCHI/BLOOMBERG/GETTY IMAGES



National Lawn Equipment looked to GE Capital for seed money.

In a world of megastores, Rob Bernier and his 10 employees in Mahwah, NJ, stand apart. Since 1990, great products and outstanding customer service have helped National Lawn Equipment grow. Rob wanted a customer financing partner that really understood his business, so he turned to GE Capital. It's a partnership that has helped keep the Garden State a little greener.

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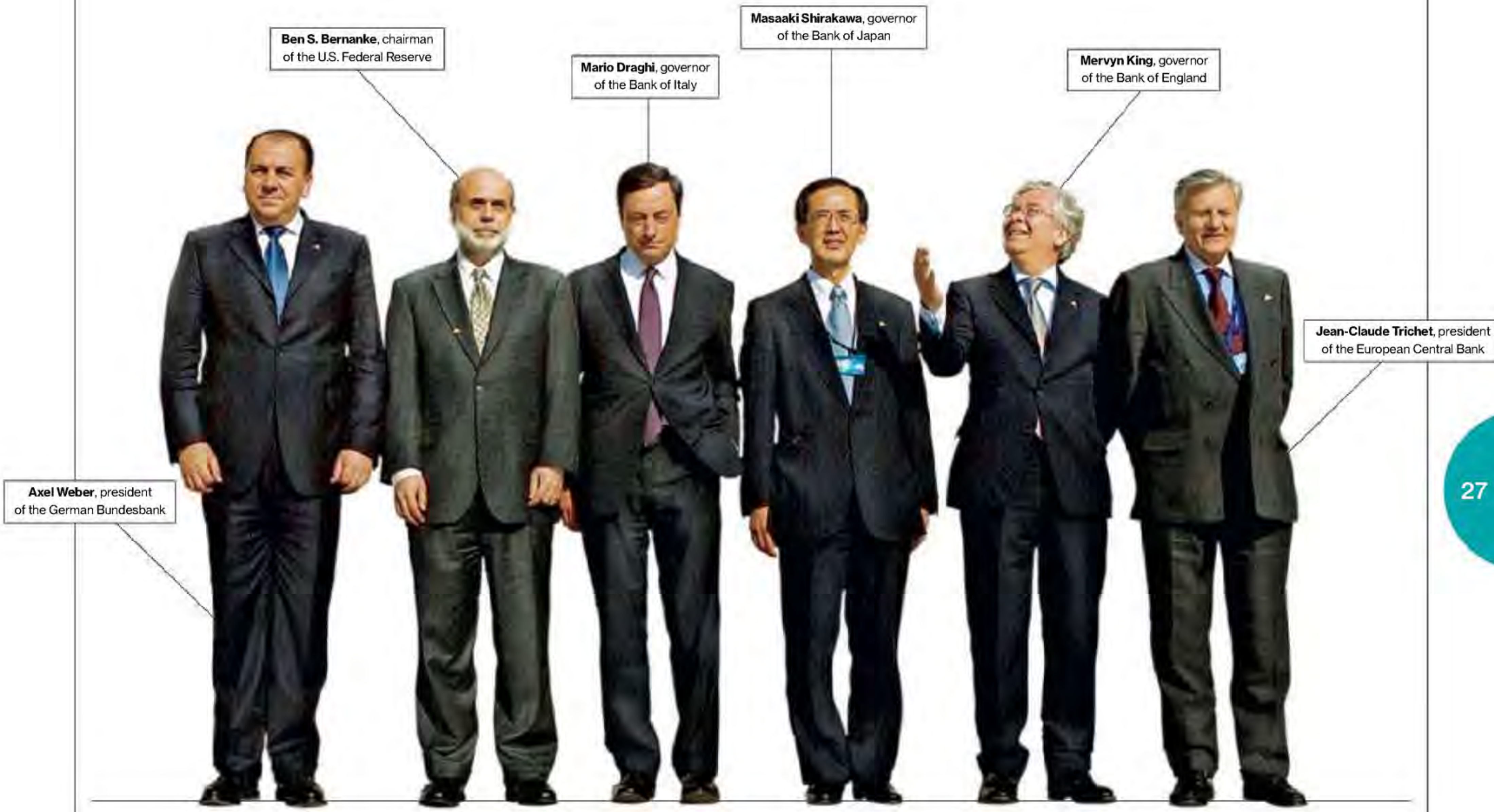
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Central Bankers Can't Return to Simpler Times



BRIAN SMIALOWSKI/GETTY IMAGES

▶ There's no end to the political demands, even as economies recover

▶ "We're going to end up with much higher inflation"

When Federal Reserve governors held an emergency conference call with the presidents of the regional Fed banks on May 9 to discuss the spreading Greek debt crisis, some policymakers voiced concern that lending a hand to Europe might not play well in the U.S. Congress. The Senate was in the middle of a debate to overhaul the financial system, and some Fed officials said that assisting Europe might encourage lawmakers to rein in the central bank's independence. In the end the Fed approved short-term currency swaps with foreign central banks after Chairman Ben S. Bernanke argued that the Fed needed to do what was best for the U.S. economy and could deal with the politics by better explaining its actions.

It's not the first time a central bank has confronted politicization, though the collisions have certainly increased as bankers—and their emergency rescue maneuvers—have become electoral fodder. It turns out that it's hard to retreat to a quiet life of making monetary policy after committing trillions of public dollars to save the global economy.

Even as the world's economies improve there are all sorts of new political demands confronting central bankers. In Britain, Bank of England Governor Mervyn King was asked to weigh in on the fiscal diet pieced together by the new Conservative-led coalition government, including $9 billion in budget cuts. (King pronounced it "very strong and powerful.") European Central Bank President Jean-Claude Trichet has had to defend his bank's purchases of troubled government debts as part of the region's nearly $1 trillion package to restore calm to financial markets. In the U.S., Bernanke has conducted a modified public campaign to burnish the Fed's image, touring a Tasty Baking cupcake factory in Philadelphia like a retail pol on May 13, and even chatting up employees.

> **"We're getting far, far away from the model of the independent central bank"**

Angry birds, happy Finns
page 39▶



Beyond removing central bankers from the important, time-consuming work of promoting economic growth while keeping inflation at bay, there are dangers to this trend. Monetary policy was designed to be conducted independent of political pressure for good reason: Central bankers are freer than lawmakers focused on the next election to take the painful steps needed to control inflation. Independent central banks also can better resist pressure to use the power of the printing press to finance government largesse.

If political considerations play a more prominent role in central banks' decisions, some economists worry that interest-rate policy could tip in the direction of short-term expediency. "We're getting far, far away from the model of the independent central bank," says Carnegie Mellon University professor Allan Meltzer, author of a two-volume history of the Fed. "We're going to end up with much higher inflation."

To prevent that from happening, central bankers need a new playbook to deal with the new pressures they're facing. They will have to do a better job explaining what they are up to and why, both to the public and elected officials, says New York University professor Mark Gertler, who co-wrote research papers with Bernanke when the Fed chairman was at Princeton University. At least a little politicking—both the grass-roots kind Bernanke conducted in Philadelphia and the back-channeling that is routine on Capitol Hill—is crucial to fending off political attacks on their independence.

So far the Fed looks to have beaten back its biggest threats, including a proposal by Senator David Vitter (R-La.) to allow continuous congressional audits of its policies. Bernanke took to the phones to persuade lawmakers to reject the measure while regional Fed presidents—led by Thomas Hoenig of Kansas City—pitched in by visiting lawmakers.

Other central banks have been less successful at preserving their autonomy. The South Korean government broke a decade-long precedent by sending a senior finance ministry official to the meetings of the Bank of Korea starting in January in an attempt to keep interest rates down. Bank of Japan Governor Masaaki Shirakawa doubled a lending program for banks in March, under pressure from Finance Minister Naoto Kan to do more to help the economy.

To ease the pressure on Greece and other European governments from surging interest rates, the ECB has begun buying sovereign bonds while stepping up its pleas to the region's political leaders to reduce red ink. There is no alternative to euro-area budget consolidation, Bank of Italy Governor and ECB Governing Council member Mario Draghi said on May 11.

The move, though, has shaken investors' faith in the ECB. "It's very unusual for a central bank to be buying what is distressed debt," says John Taylor, a professor at Stanford University and author of the Taylor Rule that policymakers worldwide use to help set interest rates. "It does raise questions about the independence of the ECB." Those concerns were fanned by comments from Axel Weber, also an ECB Governing Council member and president of Germany's central bank, that the bond purchases posed "significant" risks to the financial stability of the region.

With global investors growing more antsy about financing record budget deficits of the industrial nations, the demands on central banks to step into the breach are not likely to end soon.
—Rich Miller

The bottom line *Central bankers joined the political fray when they rescued their economies. Now they're finding it hard to retreat.*

2.34

TRILLION DOLLARS

Value of assets on the Federal Reserve's balance sheet as of May 12, compared with $874 billion in August 2007.

Financial Regulation

A Wall Street Sheriff With Fewer Bullets



BAIR/OBAMA: ROGER L. WOLLENBERG/NEWSCOM

▶ **The FDIC's Bair is losing out to the Fed in the regulatory overhaul**

▶ **She has "credibility," but "the Fed is still the central bank"**

As lawmakers crafted the financial regulatory reform bill, a lot of bureaucratic power in Washington was suddenly up for grabs. A couple of months ago, Sheila C. Bair, chairman of the Federal Deposit Insurance Corp., seemed likely to get expanded responsibilities at the expense of Federal Reserve Chairman Ben Bernanke. It didn't turn out that way.

Bair certainly continues to play a high-profile role within the Obama Administration. A recent *Time* cover story designated her as one of the "New Sheriffs of Wall Street," along with Securities & Exchange Commission Chairman Mary L. Schapiro and Elizabeth Warren, who oversees a panel tracking the Troubled Asset Relief Program bank bailout.

Yet Bair has been losing some of the ground she gained earlier in the year. She failed to win Senate approval (though it passed in the House) to set up a $50 billion industry-paid fund to cover the costs of winding down failed banks in the future. Other Bair priorities have fallen short, including an attempt to keep the Treasury Dept. from running a special council of regulators to monitor systemic risk. A Republican effort to place the consumer watchdog agency within the FDIC went nowhere. The agency will be housed within the Fed.

Meanwhile, as senators put the final touches on the financial regulatory reform legislation, the Fed is poised to keep oversight of the largest U.S. financial firms. The Fed will also

9 OF THE "BEST FUNDS THROUGH THICK AND THIN"

- MONEY® magazine, January 2010

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Sheila Bair, Federal Deposit Insurance Corp. chairman

retain its supervision of 5,000 smaller banks, a responsibility the Senate initially proposed giving to the FDIC. Bair has "a lot of credibility, but the Fed is still the central bank," says John L. Douglas, a former FDIC general counsel now a partner with Davis Polk & Wardwell.

The FDIC is pleased with a "credible and effective" Senate bill, says spokesman Andrew Gray. The agency is expected to get new powers that will allow it to quickly shut down big Wall Street firms like Bear Stearns and Lehman Brothers that run into trouble and threaten the U.S. financial system. Bair is also continuing to press for an amendment to the pending legislation that would enable the FDIC chair to launch enforcement actions without the approval of the agency's board.

Still, the FDIC's setbacks are noticeable, especially since Bair has been a ubiquitous presence on Capitol Hill, testifying numerous times in 2009 and conferring regularly in closed-door briefings with staff and lawmakers. Bair won over Democratic majorities in Congress with her campaign to use part of the $700 billion in bailout funds to help struggling homeowners renegotiate their mortgage payments. Bernanke, in contrast, took heat for the Fed's role in bailouts like American International Group's and lax enforcement of mortgage rules that fueled the subprime crisis.

However, the White House continued to back Bernanke and the Fed's role as a regulator of the U.S. banking system in the face of Senate efforts to strip the central bank of that power. The presidents of the Fed's 12 district banks also lobbied furiously (and successfully) to continue regulating smaller banks.

The $50 billion fund that Bair had wanted for the FDIC was lost in the Senate as Republicans singled it out as a slush fund for future government rescues. "That was just too easy a target for Republicans, and Democrats realized that," says Wayne Abernathy, an executive vice-president at the American Bankers Assn. "Even the Administration recognized that if you have a big pot of money sitting around, the markets are going to assume you're going to use it." —*Robert Schmidt and Phil Mattingly*

The bottom line *In the new regulatory framework the FDIC may not gain as much new power as the agency had hoped.*

Quoted

"I have a message, a message from the Tea Party, a message that is loud and clear and does not mince words: We have come to take our government back."



—Rand Paul, a Tea Party favorite, in his victory speech after clinching Kentucky's May 18 Republican Senate primary race

Lobbying

Big-Bank Nightmare On K Street

▶ Once-obscure lobbyists for the big banks are being outed

▶ "We should pay more attention to who our friends on Facebook are"

"Lobbyist" has always been something of a dirty word, so Washington's "government affairs executives," to use their preferred moniker, have tried to operate in relative obscurity. A campaign to put K Street, where many lobbyists' offices are located, in the spotlight is changing that.

A network of community organizers called the National People's Action in cooperation with the Service Employees International Union and the AFL-CIO sent hundreds of protesters to lobbyists' homes and offices in mid-May.

The effort was kicked off earlier this month when the SEIU and others released a 23-page report, "Big Bank Takeover: How Too-Big-To-Fail's Army of Lobbyists Has Captured Washington." Dozens of lobbyists are pictured on the cover, including Michael Paese of **Goldman Sachs** and Peter Scher of **JPMorgan Chase**. Mixed in with the standard shots of men in suits in front of the Capitol are photos culled from Facebook, including one of Citigroup lobbyist Maura Solomon in a tank top and A.J. Wojciak, a former outside lobbyist for the bank, smiling under his baseball hat. Solomon's picture is no longer publicly available on the site. "This report makes one thing clear—we should pay more attention to who our friends on Facebook are," says Israel Klein, a principal at **Podesta Group** who was singled out for his work on behalf of **Bank of America** and **Wells Fargo**.

BofA Deputy General Counsel Gregory Baer, who provides legal advice on regulatory and legislative activities, was summoned home on May 16 by his teenage son after hundreds of protesters swarmed his house chanting "Bank of America, bad for America." Baer, says a bank spokeswoman, isn't even a lobbyist. —*Robert Schmidt*

The bottom line *Unions and consumer activists are determined not to let Washington lobbyists press Wall Street's case on regulatory reform in obscurity.*

FROM TOP: DANIEL ROSENBAUM/THE NEW YORK TIMES/REDUX; ED REINKE/AP PHOTO

Sanctions

Honeywell is Pressured To End Iran Ties



- An advocacy group gears up a name-and-shame campaign
- Closing loopholes is a matter of "moral authority" for the U.S.

As the Obama Administration moves closer to winning tougher U.N. sanctions against Iran, the loopholes allowing U.S. companies to do business with the Islamic regime may be closing. **Honeywell International** and its chief executive officer, David M. Cote (above), are already feeling the heat.

On May 18, Secretary of State Hillary Clinton announced that longtime holdouts China and Russia had agreed to back new Security Council-imposed sanctions, including ship inspections and an arms embargo. Congress is also close to completing legislation that would ban U.S. companies from doing business with European, Chinese, or Russian outfits that trade petroleum products with Iran or help upgrade its crumbling refineries. The measure, which expands a 1996 law that bars U.S. companies from direct investment in Iran, would target those like Honeywell that do business there through foreign subsidiaries.

Honeywell, based in Morristown, N.J., also faces renewed pressure from the advocacy group United Against Nuclear Iran. UANI on May 18 asked the General Services Administration and Defense Secretary Robert Gates to declare Honeywell ineligible for government contracts until it ends the participation of its wholly owned British subsidiary, UOP, in an upgrade of Iran's Arak refinery and stops selling security equipment to Tehran. The Senate version of the legislation would accomplish much the same.

FROM TOP: LANDOV; STEPHEN CHERNIN/AP PHOTO; KHUE BUI (2); NOAH BERGER; DOUGLAS HEALEY

Real Estate

The Great Equalizer

A government perch may offer power and influence—not to mention free parking—but affords no protection from the housing crunch. The one-quarter of U.S. households now underwater on their mortgages may take consolation from the soggy real estate investments of some government leaders. Using data from Zillow, a Web site that provides home valuations based on comparable sales, and other sources, we compiled a list of who's up and who's down.
—*Cristina Lindblad, Ira Boudway, and Caroline Winter*



Timothy Geithner
Larchmont, N.Y.

The man charged with helping struggling American families hang on to their homes has not been able to get rid of his. Geithner paid $1.60 million for a 5-bedroom Tudor in the upscale suburb of Larchmont in August 2004. The home was listed for $1.63 million in February 2009, shortly after he became Treasury Secretary. It's now being rented out. Lucky for Geithner the Bethesda (Md.) ranch house he bought in August 2009 for $947,000 is holding its value, says a local broker, thanks to some interior renovations.



Ben Bernanke
Washington

When it comes to real estate, the Federal Reserve chairman's timing hasn't been the best. Bernanke bought his four-bedroom Capitol Hill townhouse for $839,000 in May 2004. Prices in the area peaked 18-24 months later, boosting its value to around $925,000. The home is now worth at least $30,000 less, according to a local agent.



Peter Orszag
Washington

The Office of Management & Budget director purchased his 3,000+ sq. ft. home in 2001 for $710,000. At the peak in 2006, the northwest D.C. bungalow would have fetched $1.27 million, according to Zillow. Local brokers reckon it's worth at least that today since the neighborhood remains a sought-after address, thanks in part to good schools.



Nancy Pelosi
San Francisco, Calif.

House Speaker Nancy Pelosi (D-Calif.) has fared better than her peers, likely because her husband is an experienced real estate investor. The couple paid $2.25 million for their 3,300 sq. ft. Pacific Heights home in late 2007, well after the market had peaked. Zillow lists the value of the 1938 house at $5.78 million, a figure that checks out with area brokers.



Robert Shiller
New Haven, Conn.

Few have tracked the real estate market more closely than Shiller, one of the architects of the widely cited S&P/Case-Shiller home price index. The Yale professor paid $62,000 for his five-bedroom New Haven home in 1989. It was worth about 10 times that at the peak, but has since shed $177,000, for an estimated value of $561,500, says Zillow.

DATA: ZILLOW, LOCAL BROKERS

While Honeywell's dealings with Iran don't violate current law, getting it and other companies to stop using subsidiaries is a matter of asserting America's "moral authority," says UANI President Mark Wallace. It's a lot harder to pressure foreign companies to pull out of Iran "if we can't even convince our homegrown companies to do that," he adds.

Rob Ferris, a Honeywell spokesman, says the company is legally bound to honor existing contracts, though it has committed to accepting no new business in Iran "in anticipation of a change in U.S. law." That's an "inadequate" response for a company that received $12.9 billion in federal contracts from 2000 to March of this year, making it the largest recipient of federal funds operating in Iran, Wallace says.

President Barack Obama regards Honeywell's Cote as one of the CEOs he most admires. Obama named him to a bipartisan budget deficit commission. UANI has some White House clout of its own. It lists as a founder Richard C. Holbrooke, though he resigned from the group before he joined the Administration as special representative to Afghanistan and Pakistan. Gary Samore, senior director for nonproliferation at the National Security Council, was an original board member.

Stuart A. Levey, the U.S. Treasury undersecretary responsible for applying sanctions, says U.S. companies are voluntarily pulling back from Iran after Administration prodding and public pressure. "Some companies are just making a decision based on business and political risk as well as the public attention being paid to this issue," he says.

One success story, says Wallace, is **Caterpillar**, which in February barred its overseas subsidiaries from accepting orders from Iran. If Honeywell doesn't do the same, he adds, it should brace for more pressure, including a naming-and-shaming ad campaign now in the works.
—*Julianna Goldman and Hans Nichols*

The bottom line *Tougher U.N. sanctions and interest groups have put multinationals using subsidiaries to trade with Iran in a tight spot.*

Corporate Taxes

IRS Wants Suspect Deductions Spelled Out

- Companies fear the proposed rule will trigger more audits
- "A game-changer with respect to our relationships"

IRS Commissioner Doug Shulman says tax auditors waste more than 25 percent of their time combing through thousands of pages of corporate returns to spot errors and challenge deductions. Now he's sparked an uproar by asking companies to do a lot of that work for him.

Shulman wants those with $10 million or more in assets to provide the IRS with a road map of what to look for in their returns. A rule proposed on Apr. 19 would require companies to list all tax-saving transactions that might be challenged–along with the maximum they would owe if the IRS won on every issue. Comments from the public are due by June 1, after which the IRS could adopt the rule as final. The new form, Shulman told corporate tax executives in Washington last month, would be "a game-changer with respect to our relationships with and responsibility to our large corporate taxpayers."

Companies agree on the game-changer part. They fear the proposed rule will expose them to more audits, or worse, that the IRS will simply send them a bill for the maximum amount of potential tax they owe. "This is just a fundamental shift," says Diana Wollman, a tax lawyer with **Sullivan & Cromwell** who is counseling companies on the proposal. "Now, I not only have to tell them what I think I owe, I have to tell them all the things I think they may disagree with. There's a lot of concern that auditors will feel pressure to challenge everything on the schedule."

Dominick Golio, CFO for **MedQuist**, a Mount Laurel (N.J.) health-information provider, sees another motive: "The ultimate agenda is to seek out new sources of revenue" to combat the federal deficit. Shulman says the IRS is merely trying to save time and money, and promises the form won't trigger unnecessary audits.

The IRS is looking to piggyback on an accounting rule that requires companies to disclose to shareholders details of "uncertain tax positions," or money-saving deductions, credits, and transactions that might raise a red flag. The agency wants even more information, including a rationale for each position. The form would require information on everything from exotic, cross-border transactions designed to minimize taxes to judgment calls over which expenses can be deducted entirely in a single year instead of amortized over time.

It is "emblematic of the need for comprehensive tax reform," wrote Jake Gallagher, vice-president of **Globe**, a Paradise Valley (Ariz.)-based investment company, in a letter to the IRS opposing the plan. —*Ryan J. Donmoyer*

The bottom line *A proposed IRS rule could shift the balance of power between corporations and the tax collector.*

Drawing Board



ILLUSTRATION BY RJ MATSON/ROLL CALL/CAGLE CARTOONS

James Warren

The Mystery of Welfare And the Recession



In many states, aid claims have gone down as the economic climate has worsened. Why?

Something doesn't compute about the historic welfare-to-work law backed by President Clinton and passed by a Republican-led Congress in 1996. As expected, the number of Americans on welfare has plummeted, from 4.8 million back then to around 1.7 million in 2008. Despite attempts to cast the law as a cold-blooded way to toss people off the dole, it was written—and funded—with knowledge that there would still be tough times. Thus, it set aside $2 billion in case an economic event might one day spark a rush to welfare. So why are caseloads still declining in states when there's little work to be had?

"It doesn't make sense," says Ron Haskins, who helped author the fundamental change in social policy as a staff director for the GOP majority on the House Ways & Means Committee. Unemployment is at 9.9% and nearly 40 million people are on food stamps. But between mid-2008 and mid-2009, as the recession took hold, New York, New Jersey, Michigan, and Texas were among states where cash assistance dropped, even as it rose sharply in Nevada, California, Colorado, and elsewhere. "We found no clear association between the change in the number of families receiving cash assistance in a state and its unemployment rate," said the Government Accountability Office after interviewing welfare officials in 21 states.

Welfare reform—or the Personal Responsibility & Work Opportunity Reconciliation Act of 1996—morphed the program from monthly cash payments to grants dependent on recipients seeking work via Temporary Assistance for Needy Families (TANF). The Health & Human Services Dept. administers TANF, with $16 billion budgeted annually for the states. HHS insists that states receiving funds make sure a minimum percentage of TANF recipients work a certain number of hours weekly and heed a lifetime limit of 60 months of aid. That may sound like a long time, though the program is not overly generous: A single mother of two gets less than $400 a month in assistance.

The extra $2 billion in funding was to ensure that states could take on more recipients during a recession. When it threatened to run out, the Obama Administration set aside an emergency $5 billion more. Yet "unemployment and the length of unemployment increases, and welfare rolls are merrily going down!" says Haskins, now the co-director of the Brookings Institution's Center on Children & Families. He can't make sense of it.

What we know is that more than 3 million people eligible for welfare are not taking part. According to the little-noticed GAO report, released in March, the reasons people are scared off include rules mandating job-related searches; declining cash benefits, which "have not been updated or kept pace with inflation"; and sanctions tied to the search process. Investigators also discovered state "diversion strategies" to keep applicants from staying on the program. States can steer applicants into taking a lump sum for, say, three months of assistance; then they're not counted on the state's regular TANF rolls or required to maintain contact with the welfare office. Says Larry Temple, executive director of the Texas Workforce Commission: "The paternalistic 'we know better' attitude is what got us into trouble. For some this is the best thing."

Perhaps, though there are other factors that indicate the choice may not be entirely up to the individual. For one thing, that $2 billion set-aside? Budget-strapped states have pilfered it to fund child-care programs and other measures that aren't actually welfare. There's also a perverse incentive to decrease the rolls. A state can drop the percentage of recipients who need to seek work if the state reduces the total caseload. Temple concedes there has not been "the uptick people thought we'd have" but says that's because Texas is more efficient than other states in finding jobs for TANF recipients. Texas currently has 45,000 people on TANF and 8.2 percent unemployment, compared with 220,893 people in the program and 5.6 percent unemployment in 1996.

The law has altered the public perception of welfare and the culture of state administrators. It has been a sign of weakness to have caseloads go up, meaning new state welfare chiefs, like Jennifer Hrycyna in Illinois, confront not only their staffs' reflex to deny benefits but also the challenge of easing onerous rules. Instead of a family of three needing to earn less than $6,000 a year to be eligible in Illinois, the ceiling will soon be $9,000. "Work requirements should be structured to provide meaningful opportunities to recipients that will lead them toward long-term self-sufficiency," says Hrycyna, "rather than pushing people into unstable low-wage jobs that get families off the rolls but leave them in poverty." Congress will have to reauthorize the welfare act next year. It would be wise to figure out who the program is really for: the states or their citizens?



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Technology

How Craig McCaw Built A 4G Network on the Cheap



▶ **The mobile pioneer's Clearwire controls airwaves worth $20 billion or more**

▶ **"You can never be too rich, too thin, or have too much spectrum"**

Craig McCaw's quest to dominate the emerging era of fourth generation, or 4G, wireless networks began in a Maryland basement office back in 2003. There, McCaw's representatives met with Rudy Geist, a lawyer with only one client, a Spanish-language broadcaster that happened to be the nation's largest licensee of the 2.5-gigahertz frequency of radio spectrum.

That band had been given away to schools and nonprofits since the 1960s. In theory, it was to be used for educational TV. In practice, the spectrum mostly languished. McCaw signed a master lease with the Spanish broadcaster, giving a Kirkland (Wash.) company he founded that year called **Clearwire** a foothold in about 20 markets.

Clearwire would end up with more than 1,000 such leases, for which it will pay about $5 billion over the next three decades. When the Federal Communications Commission in 2005 relaxed regulations on the 2.5-GHz band to encourage wireless broadband, its value exploded. McCaw was then in a position to compete against Sprint and other companies for control of a national portfolio. In 2008 Sprint, which also had 2.5-GHz holdings—and was still struggling with its 2005 Nextel merger—folded its spectrum into Clearwire in exchange for a stake in the company.

"That spectrum basically went from swampland to oceanfront property," says Brad Bowman, a community activist in Delray Beach, Fla., who advocates for municipalities to create their own 4G networks rather than rely on commercial carriers.

Today, Clearwire says the airwaves it controls are worth $20 billion or more. Now we're about to find out whether McCaw, the mobile-phone pioneer who made a killing selling McCaw Cellular Communications to **AT&T** for $11.5 billion in 1994 and later helped build Nextel, will rock the world of mobile communications once more. "Craig has the ability to bend the horizon," says Bob Ratliffe, a former senior vice-president at McCaw Cellular. "For a guy who isn't an electrical engineer, he's got an intuitive sense of where the spectrum will be valuable." (McCaw declined to be interviewed for this story.)



"For a guy who isn't an electrical engineer, he's got an intuitive sense of where the spectrum will be valuable"

Last year McCaw, who serves as Clearwire's chairman, hired former **Vodafone** executive Bill Morrow to help him create a superfast wireless network that will serve all manner of devices—from smartphones to tablet computers to gadgets not yet invented—at speeds that rival some of the broadband connections now offered by cable and phone companies. Clearwire advertises 4G wireless as four times faster than 3G.

It's safe to say Morrow hasn't had a boss quite like the 60-year-old McCaw before. Morrow sometimes finds himself summoned over to McCaw's office, where the billionaire holds forth with "philosopher-type views" on how to use the public's airwaves to "disrupt" entrenched telecommunications giants. "Next thing you know, I'm getting two or three books sent over as gifts to me," says Morrow.

Yet Morrow wasn't signed on to be McCaw's literary pal. The two executives are trying to out-hustle far bigger rivals **Verizon Wireless** and AT&T, the two biggest carriers in the U.S., in a mobile data market that, by some projections, will reach $93 billion in revenue by 2013. Both AT&T and Verizon are planning to roll out 4G services over the next several years using a competing technology that could turn Clearwire's wireless broadband standard, called WiMAX, into the next Betamax. "I think we're in

COURTESY OF CLEARWIRE (TOWER); CHIP CHIPMAN/BLOOMBERG (McCAW)



Goldman wrestles with the SEC page 42 ▶

a better position," says AT&T spokesman Mark Siegel, calling Clearwire's technology "unproven for true mobility."

While not a household name, Clearwire has two key advantages: McCaw's massive accumulation of relatively cheap broadband spectrum, which dwarfs the airwaves of AT&T or Verizon Wireless, and a one-year head start. Clearwire already offers 4G service under the Clear brand in 32 U.S. cities and plans to add up to 50 more by the end of 2010.

To reach that number, the company is in the midst of a high-speed build-out. Last year the company put up 5,000 cell sites at a cost of $130,000 to $150,000 each. "That broke the record," says Morrow, 50. "This year we're doubling that in terms of the number of sites we're constructing." In 2010, Clearwire will spend up to $3.2 billion, the bulk of that on capital expenditures.

Consider what's involved in putting up a single tower: leasing or buying real estate: winning community support and zoning permits, sometimes over fierce opposition; and paying as many as 25 workers to erect structures up to 400 feet high. The process takes from nine months to three years, says Dave Cloud, co-owner of **NuHites Construction Services** in Arkansas, which has installed equipment for Clearwire. "The task and the resources to do this build-out are enormous," says technology consultant Chetan Sharma. He figures Clearwire is putting up a tower an hour–including weekends.

For Clearwire, much is riding on whether its strategy of buying up some 85 percent of the 2.5-GHz spectrum band will pay off. Some big tech players are clearly willing to bet sizable money on McCaw. Two years ago, Clearwire received $3.2 billion in investments from **Comcast**, **Intel**, **Time Warner Cable**, **Google**, and **Bright House Networks**. Last year, Clearwire raised an additional $1.5 billion from a group led by **Sprint Nextel**, prompting one Wall Street analyst to call the McCaw company "too strategic to fail." Sprint is now the majority shareholder of Clearwire and offers high-speed mobile Web service under the brand Sprint 4G. Sprint is releasing the first 4G smartphone in the U.S. on June 4.

The $5 billion Clearwire will pay its license holders for its spectrum over the next three decades is a bargain compared to what its rivals are paying. (Clearwire's $20 billion valuation of its spectrum may prove to be conservative; J.H. Snider, former research director at the New America Foundation's Wireless Future Program, puts the number closer to $50 billion.) AT&T and Verizon bought their spectrum that can be used for 4G at government auction in 2008, paying a combined $16 billion.

AT&T and Verizon may have paid more, but those companies contend that their lower frequency, 700 megahertz, lets radio signals travel farther on less power and do a better job of penetrating buildings and other objects. "Clearwire will have to build two, three, maybe even four times the number of cell sites to get the same coverage," says Nicki Palmer, Verizon Wireless' vice-president for networks. Morrow disputes that assessment. In cities, where the bulk of customers are, he says, "you build the same amount of sites within a city whether you're on 700 MHz or 2.5 GHz."

Even more pressing than the questions about coverage is the possibility that at its current rate of spending, Clearwire will burn through its cash in 2011, according to Steve Clement, an analyst at Pacific Crest Securities. Clearwire may need $3.8 billion more to reach its goal of building a network that covers 270 million people, Clement says.

Then there's Clearwire's bet on WiMAX. Analysts increasingly see the technology backed by AT&T and Verizon Wireless, called LTE, for "long term evolution," as the industry standard. That could limit the number of cool new devices Clearwire and its reseller partners can offer customers and could ultimately force Morrow to convert the network to LTE at a cost of hundreds of millions of dollars. "It looks almost certain that Clearwire will move to LTE within a matter of 24 to 36 months," says Sharma, the technology consultant.

Although Clearwire has never been profitable, it has about 1 million subscribers, double what it had a year ago. It added 283,000 net new subscribers in the first quarter, compared with 133,000 new customers in the previous quarter. "They're announcing nice growth in subscribers, but that growth is off of a very small base," said Jeff Belk, a San Diego-based telecom consultant and former Qualcomm executive. By comparison, Verizon Wireless alone has 93 million customers, all of whom the company will try to convert to its 4G service.

However the 4G race shakes out, Clearwire can count on its "oceanfront" spectrum holdings to remain valuable

Cell Towers by the Numbers

20

Minimum number of workers it takes to build one tower

80 to 400 feet

Range of height

9 months to 3 years

How long it takes to build one tower, including permits, construction, etc.

10,000

Number of towers Clearwire plans to build this year

$130,000

Approximate cost to build one Clearwire tower

DATA: CLEARWIRE, NUHITES CONSTRUCTION SERVICES

Quoted



"What have you done that's so great? Do you create anything, or just criticize others' work and belittle their motivations?"
— Apple's Steve Jobs in an e-mail exchange with blogger Ryan Tate of Gawker Media

ERIC RISBERG/AP PHOTO

even if the company's retail efforts fizzle. For example, consumer electronics companies have recently been expressing interest in including Clearwire's service with Internet-enabled devices like computer tablets, Morrow says.

"A lot of spectrum is extremely valuable when you think about the exponential growth of mobile broadband data needs," says Sriram Viswanathan, an Intel vice-president and general manager of its WiMAX program. "Anyone that has more spectrum is going to be in a much better position." Or, as Belk puts it: "You can never be too rich, too thin, or have too much spectrum."

—Gadi Dechter and Olga Kharif, with additional reporting by Peter Robison

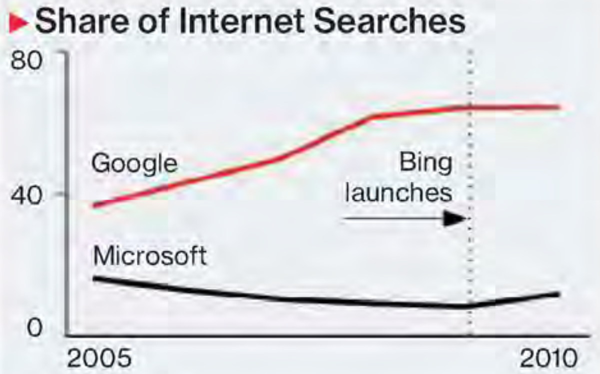
The bottom line *Even if Clearwire's retail business sours, it will be able to resell 4G services to other carriers and device manufacturers.*

The Internet

Bing Seeks, and Finds, A Foothold in Search

▶ Microsoft's big challenge is to woo online advertisers

▶ Share of Internet Searches



DATA: COMSCORE

If **Microsoft**'s goal was to hear Bing used as a verb, there are signs of success. In April about 12 percent of all Web searches were performed using Microsoft's year-old search engine. While that doesn't exactly make Bing a **Google** killer, it seems to be holding its own. Searches on Bing are up 4 percent since its launch a year ago, according to comScore. Meanwhile, Google's share is flat at 64 percent. "I do hear people saying 'I Binged it,' " says Danny Sullivan, who runs the search-analysis Web site Search Engine Land.

Microsoft has been trying to build its presence in search since 2004 (its last pre-Bing effort was called Live Search). Despite huge investments, Microsoft's share of all Net searches fell eight percentage points between 2004 and 2009. Most of the roughly $6 billion in losses racked up by Microsoft's online business division since 2006 are related to search, estimates Matt Rosoff, an analyst with market research firm **Directions Marketing Group**.

For Bing to be successful, the bump-up in searches will have to translate into more business from advertisers. For years, many companies that wanted their ads to appear alongside search results have sought a strong alternative to Google to get better prices. **Range Online Media**, a search-marketing firm, says most of its clients spend 5 to 9 percent of their budgets with Bing, up from the 2 to 5 percent they spent on Microsoft's search products two years ago. Curt Hecht, head of **Publicis Groupe**'s digital ad technology unit, says some clients who had been taking a "wait-and-see" approach to Bing are now asking whether they are "underinvested" in Microsoft's search engine.

Bing moved away from Google's minimalist formula of a plain white page with a search box that produces a list of 10 blue links. Instead, Bing's home page showcases a daily high-resolution photo. There's the usual column of results in the middle, and a list of relevant categories on the left. If you Bing Lady Gaga, for example, these categories include "Lyrics" and "Albums." This month, Google unveiled a redesigned search page with a similar layout. "It certainly seems that they've been spurred by something over the past year," says Mike Nichols, Bing's general manager. (Google spokesman Gabriel Stricker: "We have many competitors, and we take them all seriously.")

Bing may never come close to passing Google as the top search engine, but it may not have to. A 2009 deal with **Yahoo!** makes Bing the search technology that Yahoo will use on its Web sites, though it won't use the Bing name. If Yahoo and Microsoft hold their current shares, Bing will power nearly 30 percent of all searches. "At that size, advertisers can't ignore them," says Rosoff.

The Bing team is pushing for a bigger slice of a market that Google doesn't yet control: mobile devices. While Google is the default search engine on Apple's iPhone and other

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A PORTFOLIO OF IDEAS

Will we grow our way out of the deficit? Or tax our way out of it?

"The tax system today is not up to raising the revenues we need in the future."

Rosanne Altshuler
Director,
Tax Policy Center



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Technology

products, Microsoft is cutting deals to entice phone owners to give Bing a try. For example, Microsoft covers the cost of free songs given away by **Tapulous** every time a fan of its Tap Tap Revenge game agrees to download the Bing app for the iPhone. Says Peter Farago of Web analytics firm Flurry: "Microsoft is being very smart in terms of building market share for Bing in mobile." —*Dina Bass and Peter Burrows*

The bottom line *Bing may never pass Google as the No. 1 Web search engine. On mobile devices, though, the battle for dominance is not over.*

Google's Privacy Snafu



For years, Google has used camera cars (like the one above at a March trade show) to take pictures for its maps. Turns out the cars were also collecting private data from wireless networks–accidentally, the company says–as they drove around. German authorities found out and are considering a criminal probe. Google has apologized.

Medicine

A New Prescription: Parasite Eggs

- ▶ Scientists test whether whipworms can fight autoimmune disorders
- ▶ The eggs are so tiny "all you see is a small cup of water"

Whipworms are two-inch-long parasites that sicken pigs by burrowing into their guts. Scientists, however, are beginning to appreciate them for their curative power in humans. Large-scale trials underway in Europe are testing whipworm eggs as a treatment for autoimmune diseases such as Crohn's, a digestive ailment, and multiple sclerosis. About 23.5 million Americans have some type of autoimmune disorder. "This is probably the biggest market in the entire history of medicine," says Detlev Goj, founder of **Ovamed**, a German biotech. He believes whipworm eggs may prove effective against as many as 60 diseases.

Goj, who in 2002 got European regulators to approve the use of maggots to clean wounds, became interested in whipworms after coming across a 2005 study in which 21 out of 29 patients with Crohn's disease went into complete remission after being dosed with the parasite's eggs. The data seemed to support the "hygiene hypothesis," which holds that people have become too clean for their own good. The thinking is that parasites may act on the immune system by boosting the T-cells that help identify and kill infectious agents. When those cells don't work properly, substances and tissues normally present in the body can be mistakenly targeted, causing a range of disorders. "Now that we've eliminated parasites in many Western countries," says Goj, "the immune system doesn't get the required challenge anymore."

Ovamed has supplied sterilized batches of whipworm eggs for human trials for Crohn's disease, multiple sclerosis, peanut allergies, and for symptoms of autism. One of Goj's partners is **Asphelia Pharmaceuticals**. That San Diego (Calif.)-based company is projecting peak annual sales of about $2 billion in North America for its treatment for Crohn's.

But what about the yuck factor? Will people willingly infect themselves with worms under doctor's orders? Goj, whose company is conducting phase two trials in Crohn's disease at 40 medical centers in Europe, does not anticipate any resistance. "The eggs of the whipworm are so small they're hard to find on a microscope," he says. "All you see is a small cup of water." And since the worms don't reproduce in humans, the parasites are gone in about two weeks.

Whipworms aren't the only invertebrates commanding attention. A 2007 study in Argentina found that MS patients who were infected with *Schistosoma mansoni*, a parasite found in water supplies in poor countries, suffered fewer relapses than those who were

Power to the Parasites
After decades of fighting them, doctors are finding new uses for these biological freeloaders.



Eggs from pig whipworm are being tested against Crohn's disease



Blood fluke parasites may help multiple sclerosis patients avoid relapses



Pin-sized hookworm could guard against asthma

TOP: RALPH ORLOWSKI/BLOOMBERG; BOTTOM, FROM LEFT: CNRI/PHOTO RESEARCHERS; NIBSC/PHOTO RESEARCHERS; DAVID SCHARF

not. An immunologist at the University of Nottingham has been looking into whether pin-sized hookworms may protect against asthma, Crohn's, and MS. —*Elizabeth Lopatto*

The bottom line *Parasites are being used to treat autoimmune diseases. Some researchers believe people can be too clean for their own good.*

Online Games

Angry Birds, Happy Finns

▶ **The No. 1 game on the iPhone is a hit for Helsinki-based Rovio**

▶ **When a co-founder's mother got hooked: "Now we have something!"**

The top seller at Apple's online App Store this month is a fiendishly simple game called Angry Birds. Players use the touchscreens of their iPhone, iPod, or iPad to sling a variety of angry-looking cartoon birds at green pigs that have stolen their unhatched eggs. The pigs have hidden themselves under piles of sticks, stones, and blocks of ice. (The game costs 99¢.)

Rovio, a mobile-game maker in Helsinki, released the game last December. The company says more than 2.5 million users worldwide have downloaded it. The 17-person shop created Angry Birds over the better part of a year during spare time from contract work for Nokia and Electronic Arts. They're now working full time on creating updates. Niklas Hed, Rovio's 30-year-old co-founder, says he tested Angry Birds on his mother. "She doesn't play games at all," says Hed. "Last Christmas I gave it to her, and she was still playing even though we had guests coming over. I thought, 'O.K., now we have something!'"

Chief Executive Officer Mikael Hed, Niklas's 34-year-old cousin, says he hopes the game can be parlayed beyond the App Store into other smartphones, videogame consoles, PCs, and perhaps TV or film. *Angry Birds: The Movie*? Somewhere, Alfred Hitchcock is smiling. —*Ira Boudway*

The bottom line *To keep Angry Birds at the top of Apple's App Store charts, Rovio's 17 employees are now working full time on creating game updates.*

Innovator

Barry Kahn



PHOTOGRAPH BY JEFF WILSON FOR BLOOMBERG BUSINESSWEEK

By helping teams set prices that will pack fans into the stands, his software could boost sports and entertainment revenues by $20 billion a year

How much is a San Francisco Giants ticket worth? Barry Kahn would tell you it changes constantly. The 28-year-old New Jersey native, with a PhD in economics from the University of Texas, has developed software that helps the Giants price baseball games in much the same way airlines manage seat prices to keep planes full. Kahn's company, Qcue (pronounced "Q-Q"), crunches numbers on dozens of variables to determine prices that will get the largest number of fans into the stands. The software helps the Giants set prices based on past ticket sales, the day and time of the game, the teams' records, the pitching match-up, the weather, the going rate on resale Web sites like StubHub, and other data.

Ticket prices used to be fixed before spring training; with Qcue, they're adjusted almost daily. Giants officials analyze each section of their 41,500-seat ballpark on a PC screen to see where prices should change. A green shading suggests the team is charging too little; red means too much. The team can test various scenarios. What does a price change in the bleachers mean for sales along the first-base line? Will fans pay $10 more for a better seat? "We want to put people in a position where they make the decision to upgrade," says Kahn, who grew to understand the risks of getting prices wrong after seeing his father's concert promotion business collapse.

The Giants say the technology could add $5 million-plus in revenue this year. Revenues are up 12% this season and attendance has jumped 7% (true, the team is playing well), even as the league has seen a slight decline. Kahn is "changing the ticket world," says Russ Stanley, the Giants' ticketing chief.

Stanley predicts that within five years the entire league will adopt market-based pricing. "Everyone is looking to see what this does for us," he says. Other sports are interested, too. Hockey's Dallas Stars are testing Qcue. The National Basketball Assn.'s Cleveland Cavaliers are working on flexible pricing with a Qcue rival, Indianapolis-based Digonex Technologies, while concert promoter Live Nation Entertainment is testing pricing software that should be ready next year.

Qcue makes money via subscription fees and by taking a percentage of any increase in ticket revenues above a certain level. That should add up to revenues of $1 million this year and $5 million in 2011, Kahn says. So far, the six-employee company isn't profitable, and Kahn keeps costs in check by crashing on a friend's couch while visiting his biggest client, the Giants. But he insists he'll soon prosper. "There's big money out there in lost revenue from mispricing," Kahn says—more than $20 billion a year for live sports and entertainment, much of it cash that today goes to scalpers. Flexible pricing, he says, lets teams "hedge their bets in bad times and capture the benefits of the good times." Ⓑ —*Adam Satariano*

Impact ▶ **Created software that calculates the best price for each seat**

Insight ▶ **Demand depends on the weather, the pitchers, the rivalry, and more**

Education ▶ **PhD in economics from the University of Texas**

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Markets&Finance



A Niska Gas facility in Alberta, Canada. Niska's stock is down 7.6 percent since its IPO

Beware of Buyout Firms Bearing IPOs

▶ **Offerings from Apollo, Carlyle, and others are in the red**

▶ **"Companies coming from private equity weren't necessarily the cream of the crop"**

The stock market rally of the past year has encouraged leveraged buyout firms to sell more of the companies they own to the public. The people who buy shares in those companies, though, have had reason to regret it. Initial public offerings from U.S. companies backed by private-equity firms are losing money, on average, for investors for the first time in at least a decade, making them the worst performers in 2010's IPO market.

The stocks have fared poorly even though in many cases buyout firms cut the prices and the number of shares in the deals. Prices of the 13 offerings this year by private-equity funds have fallen by an average of 2 percent in the first month of trading, according to data compiled by Bloomberg and **Renaissance Capital** in Greenwich, Conn. A total of 333 initial offerings backed by buyout firms generated average first-month gains of 11.4 percent from 2001 through last year, according to data compiled by Renaissance Capital, which has followed IPOs since 1991.

The IPOs have also lagged the Standard & Poor's 500-stock index, while companies without support from buyout firms have beaten that benchmark by 5.8 percentage points after their initial sales, as of May 18. More than half of this year's sales from private-equity firms left buyers with losses. **Metals USA Holdings**, owned by Leon Black's **Apollo Management** and **Niska Gas Storage Partners**, owned in part by the **Carlyle Group**, were among the companies that retreated.

The failure of buyers to profit from the share sales may hamper the funds' efforts to offload some of the companies they bought during the $2 trillion leveraged buyout-spree of the credit-market bubble. These IPO shares "have not proved very attractive for fund managers," says David Abella, a portfolio manager at **Rochdale Investment Management** in New York. "So they would probably be more likely to avoid them going forward."

As Greece's debt crisis helped spur the biggest weekly surge in stock-market volatility in two decades, at least 17 initial sales were postponed or withdrawn worldwide in May. U.S. companies that completed offerings in May were forced to cut their size by as much as 70 percent, data compiled by Bloomberg show. "There's a window when people can do IPOs," says Jonathan Vyorst, who helps oversee $1.7 billion at New York-based **Paradigm Capital Management**. "When the window opens, a lot of people rush to get deals done. That window may be closing."

"When the window opens, a lot of people rush to get deals done. That window may be closing"

Metals USA lost 28 percent in the first month after New York-based Apollo offered $240 million of shares in the company, which shapes steel and other alloys into parts. The April IPO of the Fort Lauderdale (Fla.) company was the largest U.S. offering of an Apollo company since the credit crisis.

Niska, the natural-gas storage operator owned by Washington-based **Carlyle** and **Riverstone Holdings** of New York, has fallen 7.6 percent since its May 11 offering. That's more than double the S&P 500's decline. The company was valued at 6.35 times its tangible net

assets, almost three times the median of 2.33 for 39 publicly traded U.S. competitors, Bloomberg data show.

Discounts offered to attract buyers haven't guaranteed bigger returns. While **Graham Packaging** of York, Penn., gained 12 percent in its first month after **Blackstone** cut the size of its IPO by more than half, **Global Geophysical Services** has slumped 17 percent since raising 54 percent less than **Kelso** and its co-investors asked for in April.

"Companies coming from private equity weren't necessarily the cream of the crop," says Jason Cooper, who manages $2.5 billion at **1st Source Investment Advisors** in South Bend, Ind. "That's the private-equity business model: You acquire, have these companies, and at some point you have to shed yourself of them and realize the gains."

Private-equity firms are still pressing ahead with what may be the biggest initial U.S. offering of 2010. HCA, the hospital chain bought four years ago in a $33 billion LBO led by **Kohlberg Kravis & Roberts** and **Bain Capital**, filed this month to sell as much as $4.6 billion in shares. The Nashville (Tenn.)-based company's U.S. IPO would be the largest since **Visa** of San Francisco raised $19.7 billion in March 2008.

—*Michael Tsang and Inyoung Hwang*

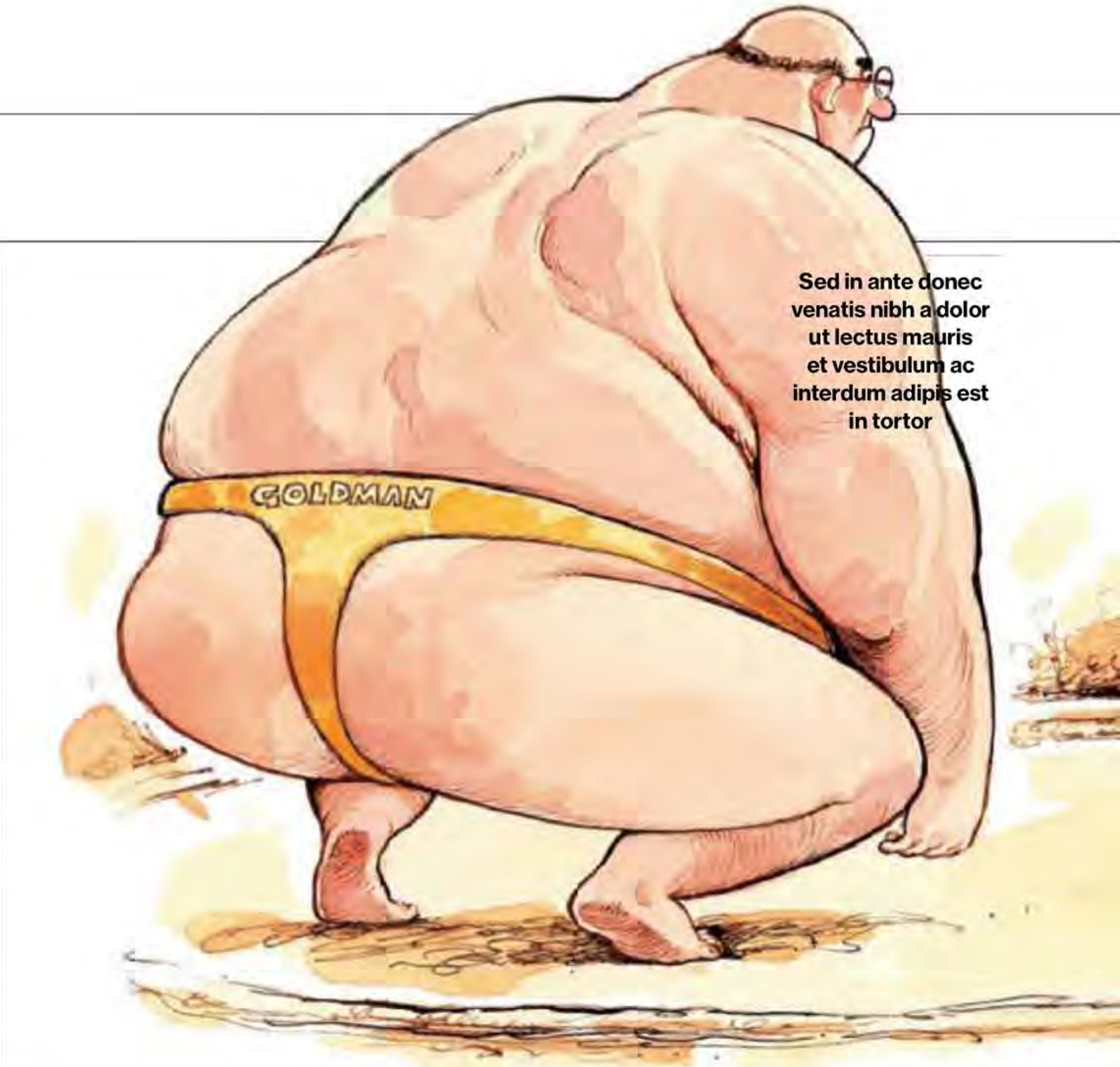
The bottom line *Buyout firms have a backlog of companies acquired during the boom. Even discount prices may not make them good investments.*

10.73

PERCENT

The percentage of prime, fixed-rate loans in foreclosure or delinquent in the U.S. in the first quarter of 2010, a record.

DATA: CALCULATED-RISKBLOG, MORTGAGE BANKERS ASSOCIATION



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Wall Street Investigations

How Big a Hit Will Goldman Take?

- Congress and the public expect the SEC to extract a big fine
- Restrictions on business can be "the hurt that keeps on giving"

As the U.S. Securities & Exchange Commission wrestles with **Goldman Sachs** to settle fraud charges, it will be under pressure from lawmakers and the public to punish the Wall Street giant with a fine that some legal analysts predict could be $1 billion or more. "There's been a lot of attention paid to this on Capitol Hill and in the press," says James Coffman, a former SEC attorney who negotiated a $300 million settlement with **Time Warner** in 2005. Coffman predicts Goldman Sachs will pay "about $100 million or more" in any accord it reaches with the SEC. Others think the tab will be higher. "The goalpost is $1 billion, minimum," says James Cox, a securities law professor at Duke University. That would be the biggest settlement ever by a financial company.

In preliminary settlement talks between the SEC and Goldman Sachs, the subject of how much money the firm may pay hasn't been discussed, according to a person familiar with the matter. SEC spokesman John Nester and Goldman Sachs spokesman Michael DuVally declined to comment.

The SEC's Apr. 16 lawsuit accused Goldman Sachs of fraud for not disclosing that **Paulson & Co.** picked the underlying securities in a collateralized debt obligation that the hedge fund planned to bet against. Goldman Sachs received about $15 million in fees while investors in the CDO lost more than $1 billion, the agency said. Goldman Sachs has denied any wrongdoing in the deal.

The SEC suit cites the Securities Act of 1933 and the Securities Exchange Act of 1934. Both laws limit their most severe fines to either $650,000 per violation or the "pecuniary gain" reaped by the defendant. According to former SEC Commissioner Paul Atkins, SEC investigators don't have to follow those limitations if they: persuade companies to pay more; a majority of agency commissioners vote to approve a settlement; and a judge signs off on the pact. "It's basically what the two sides hammer out," Atkins says.

Negotiations are more likely to stall



over the terms of a settlement than the size of any fine, said two people familiar with Goldman Sachs's thinking. Goldman Sachs would resist agreeing to an accord that said it committed fraud because doing so could affect the firm's business, the people said. Such a settlement likely would restrict Goldman Sachs and its employees from managing investment companies registered with the SEC. Goldman Sachs' asset management unit oversees mutual funds, money-market funds, and bonds funds. "Money hurts, but limitations on business can hurt in a lot more ways and that can be the hurt that keeps on giving," said Coffman, who retired as an assistant director of enforcement at the SEC in 2007.

The SEC may press Goldman Sachs to agree in future transactions to improve its disclosures to sophisticated clients like the firms that invested in the CDO, says Elizabeth Nowicki, who teaches securities law at Boston University. "That would actually be a far bigger win for the SEC" than a one-time penalty because it would likely lead to industrywide reform, she says.
—Jesse Westbrook and David Scheer

The bottom line *Even a big fine won't dent a powerhouse like Goldman. Admitting fraud, however, could damage its reputation and drive away clients.*

ILLUSTRATION BY DAVID PARKINS. MALVEY: KEITH BEDFORD/REUTERS

Global Money Flows

U.S. Assets Are a Safe Haven ... Again

- Nervous investors flock to American stocks and Treasuries
- "Reverse diversification" sends cash to the U.S. from overseas

Investors spooked by the Greek debt crisis have been seeking shelter in the dollar. Global purchases of U.S. equities, notes, and bonds totaled $140.5 billion in March, more than double economists' projections, after net buying of $47.1 billion in February, the Treasury Dept. reported on May 17.

The figures mark a change from last year, when investors, concerned about the potential impact of U.S. budget deficits on the dollar, moved money to other countries. "Diversification was a major deadweight on the dollar last year," wrote Alan Ruskin, head of foreign-exchange strategy at Royal Bank of Scotland Group in Stamford, Conn., in a note to clients. "Reverse diversification is now a major source of vulnerability for the euro."

Signs of an American economic recovery, including a rebound in earnings and stock prices, may increase demand for U.S. investments as concerns mount about the sustainability of government debt levels in Europe, economists say. The world's largest economy has expanded for three consecutive quarters and added 573,000 jobs in the first four months of the year.

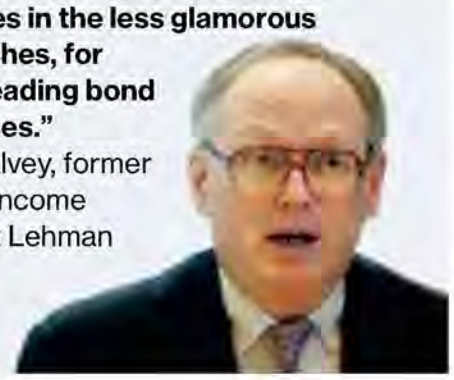
Some of the buying came from China, where Treasury holdings rose 2 percent in March to $895.2 billion, the biggest increase since July. Japan, the second-largest holder, increased its holdings by $16.4 billion, to $784.9 billion, in March.

"Foreign institutions and individuals are still turning to the U.S. as a safe haven," says Paul Christopher, senior international investment strategist at Wells Fargo Advisors. "There was some concern foreigners were abandoning the U.S. currency. That fear was misplaced."
—Vincent Del Giudice and Daniel Kruger

The bottom line *Despite record U.S. budget deficits, foreign investors continue to seek the relative safety of the dollar in times of crisis.*

Quoted

"The markets over the last several years have been really portrayed through a macro lens. There were not enough mud Marines in the less glamorous detail trenches, for example, reading bond prospectuses."
—Jack Malvey, former chief fixed-income strategist at Lehman Brothers



Stocks

Seeking Bargains in Battered Europe

- Euro zone exporters will benefit from a cheaper currency
- The Euro Stoxx 50 index



SOURCE: BLOOMBERG

Not all investors are taking the Continent-wide crisis as a reason to flee Europe. Some money managers see it as a chance to go bargain hunting. One theory: The euro's slump, to a 4-year low against the U.S. dollar, will boost exporters and lift economies.

David G. Herro of **Harris Associates**, named the international fund manager of the decade this year by Morningstar, bought shares of Spain's **Banco Santander** in the past month. He added to his stake in Paris-based yogurt maker **Groupe Danone**, which posted its fastest quarterly sales growth in two years on Apr. 15. Howard F. Ward of the **Gabelli** funds, boosted his investment in Munich-based **Siemens**.

"Global blue chips based in Europe are probably the most attractively valued equities today," says Herro, chief investment officer of international equities at Harris

Speed Dial

This Cop's Beat Is Wall Street



George Canellos left private practice 10 months ago to take over the New York office of the Securities & Exchange Commission

Canellos spoke with Bloomberg Television's Suzanne O'Halloran about the SEC's efforts to keep up with changing markets. Below are edited highlights of their talk.

What has been your main priority?
To reorient our examination and enforcement program to some areas that have not been the traditional focus of SEC work. Traditionally, the SEC has placed a great deal of emphasis on retail investors. We are very much trying to focus on areas outside that sphere, on products that are traded by and sold to institutional investors ... like collateralized debt obligations and residential mortgage-backed securities. I don't think the SEC is willing to assume [that] because a product is sold to institutional investors we should be less concerned about it.

Will we see more cases like the one against Goldman Sachs?
This office is conducting a major national sweep of collateral managers of CDOs to evaluate how they handled their responsibilities to their investors. The sweep encompasses more than 50 managers. I wouldn't want to predict which cases will and won't be brought; every case will be examined on its own merits. But it gives you the sense of the intensity of our efforts in this area.

You've said that enforcement hasn't kept pace with Wall Street's rising assets under management.
I am very concerned that hundreds and hundreds of registered financial institutions have never been examined by the SEC because of acute resource constraints. In some respects we are acting as a cop on the beat, so it is very important that these institutions be aware of our presence.

We are hiring about 40 new staff, about a 10 percent increase. Given the current conditions in the market, there are many people we are in a position to hire who otherwise we might not be in a position to hire. Another important priority for me is that our office is trial-ready, capable of taking on tough cases and prosecuting them effectively.

The 1,000-point drop on May 6 highlights the market's complexity. How are you addressing that?
We have added to our New York exam staff two experts in market structure, including dark pools and other alternative trading systems. We are in the process of seeking an expert on algorithmic trading. We have conducted training in current market structure for the entire staff. We have dedicated 10 enforcement staff to specializing solely in market abuses, and we're conducting a number of investigations of alternative trading systems. Ⓑ

Associates, parent of the Oakmark mutual funds. Herro says he's scooping up shares that have fallen too far, too fast, and 8 of the top 10 holdings in his $5.3 billion Oakmark International Fund were European stocks at the end of March. The fund returned 5.5 percent annually in the past five years, beating 86 percent of peers, Bloomberg data show. "Other people say, 'It's messy. I'm not going to go in there,' " Herro says. "But this is when you should go in."

The currency's fall should boost exporters, says David Darst, chief investment strategist at **Morgan Stanley Smith Barney**: "European stocks are a buying opportunity." Analysts lifted profit estimates for the next year for companies in the Euro Stoxx 50 index by 2.5 percent in April, the most since 2006. The index traded at 9.7 times forecast income on May 7. That was the cheapest since April 2009, before the index began a rally that sent it 35 percent higher in a year.

Credit Suisse earlier this month advised investors to favor European stocks in global holdings, citing low valuations and a weakening euro. **Goldman Sachs** strategists wrote in a report that European stocks are "down but not out" as profits increase in the region. **UBS** and **Deutsche Bank** issued recommendations to increase investments in Germany, Europe's largest market, because shares in the country are more geared to global growth than to Europe's most-indebted economies.

Amid all that enthusiasm, some sounded a more cautious note. "I wouldn't jump in," says Robert Doll, vice-chairman and chief equity strategist at **BlackRock**, which manages more than $3 trillion. "I'd still rather invest in the U.S., where the recovery is stronger." Yet buying into uncertainty can be more profitable. "Europe has become very cheap, and the fall of the euro has made it more attractive," says Max King, a London-based investment strategist at **Investec Asset Management**, which oversees about $55 billion. "If you wait until all the concerns are resolved, then you'll always be buying at the peak."
—Lynn Thomasson and Rita Nazareth

The bottom line *Investing in Europe now is a bet that the debt crisis will be contained and that the weaker euro will help big exporters improve sales.*

Charlie Rose talks to

Jonathan Nelson



Jonathan Nelson is CEO of low-profile, and highly successful, Providence Equity Partners, a $22 billion private equity firm that focuses largely on media

In the public mind, private equity is lumped together with proprietary trading and hedge funds. Is that fair?
I think we get off on the wrong track by the name. In an age of transparency, anything that's private doesn't sound very good ... and some of us are even public companies. Our debt is always registered in public and traded. And many of the companies we invest in, if they're not public themselves, operate under the scrutiny of regulators. So there is a transparency around our activities. A better name might be partner capital, growth capital, and long-term growth capital. There have been interesting studies over the past year: BCG, Bain, McKinsey, and others have studied how private equity actually creates value. It turns out we underestimated the good work we do. Over 80 percent of the value we create is in improving the operations of a business.

The ugly side comes from the notion that some people with capital borrow a lot of money, buy a company, strip and sell it, then walk away from it with a profit—or walk away after a lot of people are hurt and lose their jobs.
There are a couple of stories that have been widely reported in the press where that indeed has happened. But it's a small subset of the transactions today. It's much more often the case that companies flourish under the ownership of private-equity firms. And I think that will be increasingly the case. The days when you could cut costs and do well, they've been over for a decade.

Does private equity get an unfair tax advantage? [Profits paid to private-equity executives now qualify for the 15 percent capital gains rate. A proposal before Congress would tax the income as wages, with a top rate of 39.6 percent.]
When I take my private-equity hat off, I think: "Well, how would I view this if I were not engaged in this business?" Then I say: "All right, I don't like the notion of someone who's doing really well paying a lower marginal tax rate than someone who makes less money." That seems inherently unfair. So it seems to me the solution is a tax code [revision] that affects all partnership accounting—not just private equity but real estate, oil and gas development and exploration, and other partnership models. If we don't like people paying low marginal tax rates who do well when they create equity value, then let's apply that standard to everyone, not just a group. Seems un-American to me to single out a group for whatever reason and say we're going to change their tax rate.

You could live with it if they changed the tax rate, though?
We could live with it if they changed it overnight. Absolutely.

How will private equity be influenced by financial reform?
We actually should be irrelevant in the conversation because regulation today is or should be focused on what triggered the crisis two years ago. But reform could affect us if it gets off track. If we reduce the size of banks and limit their activities, it could have a negative effect on private equity.

Do you focus on media because it's of particular interest or because you think it has the highest return?
It's exciting, it's growing, everybody is interested. But you know, I have to go back to our beginnings. We started in cable television roughly 20 years ago. We thought we were bold when we moved into radio and television.

So you grew up in Providence and went to Brown. Where did you go to work when you got out of college?
I went to work for a company called Wellman in Boston, except within a week of graduation, I was off in China. It was roughly 30 years too early, but it was the right idea. China couldn't have been a more stimulating experience. This was 1977-80, before we had diplomatic relations.

Was it a smart move or a dumb move for Google to pull out of China?
I think it made sense for Google.

To say you can't censor our stuff, and we're not going to censor it for you?
I would have handled it differently. You need a long-term perspective to look at really anything in China. They have a very different timeline than we do. And I think that most of what Google hopes to achieve, the Chinese will get there at their pace, not our pace. It is, after all, their country. While I understand the tension, I see both perspectives. We recently partnered with Baidu, which is the Google of China. For us, we would rather participate in change than engender change by withdrawing.

So where will China be in 25 years?
We'll be looking up to them.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

OPPOSITE: MIKE MCGREGOR/CONTOUR/GETTY IMAGES. THIS PAGE, FROM TOP: CHIP EAST/REUTERS; BRAD TRENT



How machines whipsawed Wall Street page 48 ►

Takeovers

Pru Moves One Step Closer to Its AIG Prize

► Now the British insurer must get shareholders to approve the bid

► "The timing of the fund-raising is not ideal," says an investor

Prudential Chief Executive Officer Tidjane Thiam took 11 weeks to persuade U.K. regulators to authorize the insurer's $35.5 billion takeover of **American International Group**'s main Asian unit. He now has three weeks to persuade his investors, who are scheduled to meet to vote on a rights offer on June 7.

75%

The percentage of Prudential shareholders who must must bless the deal

Thiam and his management team have started a fresh round of investor meetings as they seek to gain the 75 percent of shareholder support needed to push through the $21 billion rights offer that will fund the takeover of **AIA Group**, the biggest purchase in Prudential's 162-year history.

The insurance giant issued a prospectus and sought to win over investors by promising to double Asian profits within three years and extract $1 billion from AIA within that period for dividends and investment in growth. "I'm sure Tidjane and the management will get a hard time from some investors, but armed with the information released [on May 18] they will be able to make up for some of the missteps of the last few weeks," says Martin Brown, a Glasgow-based fund manager at Ignis Asset Management. "The targets and disclosures are reassuring and broadly positive."

To gain U.K. regulatory approval, Prudential was forced to sell $5.4 billion of hybrid capital and set up a $1 billion reserve fund. Hybrid capital, which combines elements of debt and equity, is more expensive to sell to investors than the $5 billion of senior debt the insurer had planned to issue. "There is still a risk the deal does not proceed," says Jonathan Jackson, head of equities at Killik & Co., which owns Prudential shares. "The timing of the fund-raising is not ideal given the market's current nervousness over sovereign debt issues."

Neptune Investment Management and other shareholders have criticized Thiam's handling of the deal. Managing Director Robin Geffen says he is trying to rally fellow shareholders to oppose it. "This is something of a leap in the dark for the Pru," says Paul Mumford, who helps manage 417 million pounds, including Prudential shares, at Cavendish Asset Management in London. "This is not about business diversification. This is a case of putting an awful lot of eggs into a Far Eastern basket." —*Kevin Crowley*

The bottom line *Thiam has cleared the regulatory hurdle. Next he must convince shareholders that the deal is worthwhile—then deliver on that promise.*

Mutual Funds

Templeton's Master of Debt and Currencies



► In global bond funds, Michael Hasenstab is the league leader

► "He is willing to do things others would not be comfortable doing"

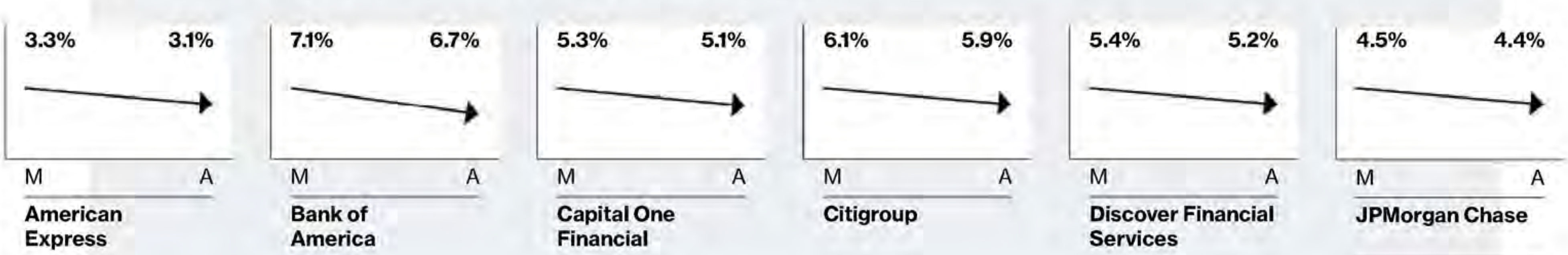
For Michael Hasenstab, manager of the top-rated and best-selling **Templeton Global Bond** fund, Greece is the latest example of why investors should avoid countries that rely too heavily on borrowed money. Hasenstab shunned debt-laden nations including the U.S., Japan and much of Europe before the Greek debt crisis erupted. He favors the debt of Asian and Latin American nations with fast-growing economies and small budget deficits.

The 36-year-old fund manager, who started at San Mateo (Calif.)-based **Franklin Resources** fresh from college in 1995, boasts an outstanding record: Templeton Global Bond returned 12 percent annually in the 10 years ended Apr. 30, the best in the world bond category, according to

Consumer Debt

Credit-card delinquencies edge down

Whether it was because of the improving economy or tax refunds, credit-card customers were finding it a bit easier to keep up with their bills in April. The percentage of loans at least 30 days overdue dropped at the six biggest U.S. card issuers.



DATA: COMPANY FILINGS

fund-research firm Morningstar. Hasenstab's fund gained 6.1 percent this year through May 17, better than 97 percent of its peers, according to data compiled by Bloomberg.

Those numbers have helped the $34 billion Templeton Global Bond pull in net deposits of $7.1 billion in the U.S. this year through April, second only to the $15 billion that went into Bill Gross' $225 billion **Pimco Total Return**, according to Morningstar. The $24 billion version of the fund sold outside the U.S. brought in $5.2 billion in the first quarter, making it the top seller in the rest of the world, according to research firm Strategic Insight.

Hasenstab looks for markets where government bond yields are attractive and credit quality is improving. Right now, he likes countries such as Indonesia and Brazil, which have manageable debt levels and the prospect of stable or declining long-term interest rates. Hasenstab also invests where he sees an opportunity to make money on currency movements. Lately, that means countries where he expects interest rates to rise, such as Norway, Australia, China, and India. "Despite global problems, these economies are robust," he says.

Australia, which represented 9.8 percent of Hasenstab's portfolio, was one of the few nations to skirt last year's global recession. The Australian dollar, which was worth 63¢ in March 2009, currently trades for almost 87¢, Bloomberg data show.

Hasenstab's strategy of making bets on both bonds and currencies distinguishes him from most rivals, says Kevin McDevitt, an analyst with Morningstar: "He is willing to do things others would not be comfortable doing." Of course, that means the fund can be riskier than one that avoids currency bets.

With debt worries roiling markets everywhere, no fund is exempt from big swings. Templeton Global Bond fell 4 percent in the week before the European plan was announced as bonds tumbled around the world. In times of panic, investors make no distinctions and sell everything, Hasenstab says, adding: "Once things settle out you will see that differentiation return." B
—*Charles Stein*

The bottom line *Hasenstab's knack for avoiding the bonds of debt-laden countries and spotting undervalued currencies helps him outperform.*

OPPOSITE: PHOTOGRAPH BY DEIRDRE BRENNAN FOR BLOOMBERG BUSINESSWEEK. THIS PAGE, FROM TOP: COURTESY OF BONHAMS AUCTIONEERS; COURTESY OF PHILLIPS DE PURY; JASON JANIK/GETTY IMAGES

Bid & Ask

$1.6bn

Finance

Amount Britain's Man Group, the world's No. 1 hedge fund firm, is paying for GLG, a smaller competitor, in what is its biggest acquisition ever. The combined firm will oversee about **$63 billion** in assets worldwide across a variety of funds.

Conglomerates

Honeywell International, a maker of aerospace equipment and other products, bid **$1.1 billion** for Sperian, a French company that manufactures protective goggles and respirators. The all-cash offer bested a rival bid from private-equity firm Cinven. The deal should help New Jersey-based Honeywell boost sales outside the U.S.



Collectibles

A London auction of Chinese ceramics and artworks put on by Bonhams raised **$30.1 million**, propelled by strong demand from Asian buyers. The main attraction was a collection of 35 white jade carvings, which sold for more than double its pre-auction estimate.

$21.1mn

Lawsuits

Punitive damages awarded by a Federal Court in a gender-bias case involving 5,600 female employees at a U.S. unit of the Swiss drugmaker Novartis, the second-largest verdict of 2010. A Manhattan jury found that Novartis had discriminated against women on pay and promotion, and because of pregnancy.

Art

A painting of a blue-eyed nurse by artist Richard Prince was among the works sold by Halsey Minor, founder of CNET Networks. The sale raised **$21.1 million** to pay creditors. Minor's collection accounted for just 22 of the 74 lots on offer at the New York auction organized by Phillips de Pury & Co., and took in more than half of the **$37.9 million** total.





Technology

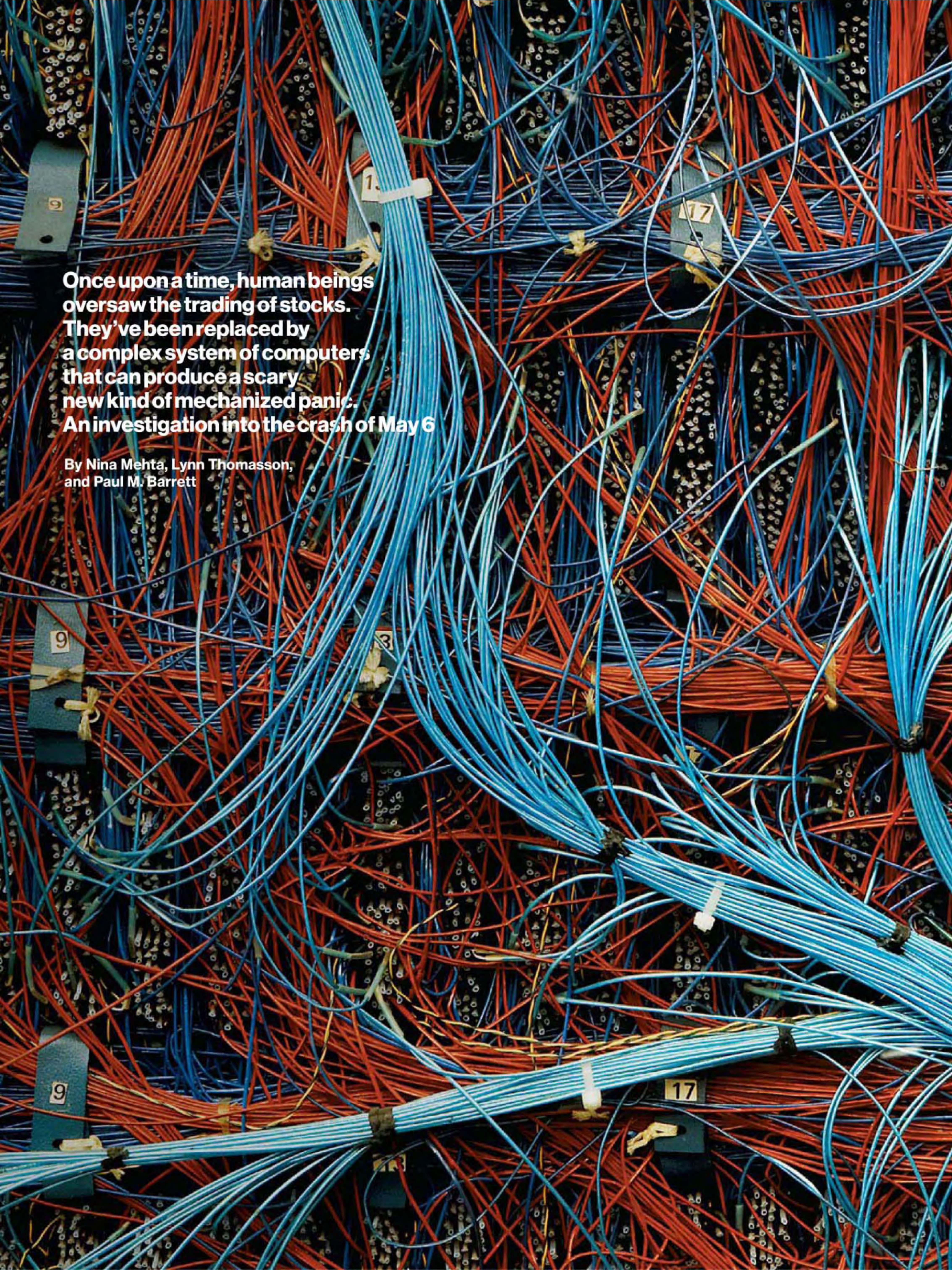
Nine chipmakers agreed to pay **$403.5 million** in the first settlement of a price-fixing case with European Union antitrust regulators. Samsung Electronics and Infineon Technologies received the biggest fines, **$176.3 million** and **$68.6 million**, respectively. Hynix Semiconductor, Toshiba, and Mitsubishi Electric also admitted participating in the cartel.

Finance

Former McKinsey director Anil Kumar is paying almost **$2.8 million** to settle civil allegations of insider trading brought by the U.S. Securities & Exchange Commission. Kumar pleaded guilty in the Galleon Group insider-trading case, the largest ever involving a hedge fund.

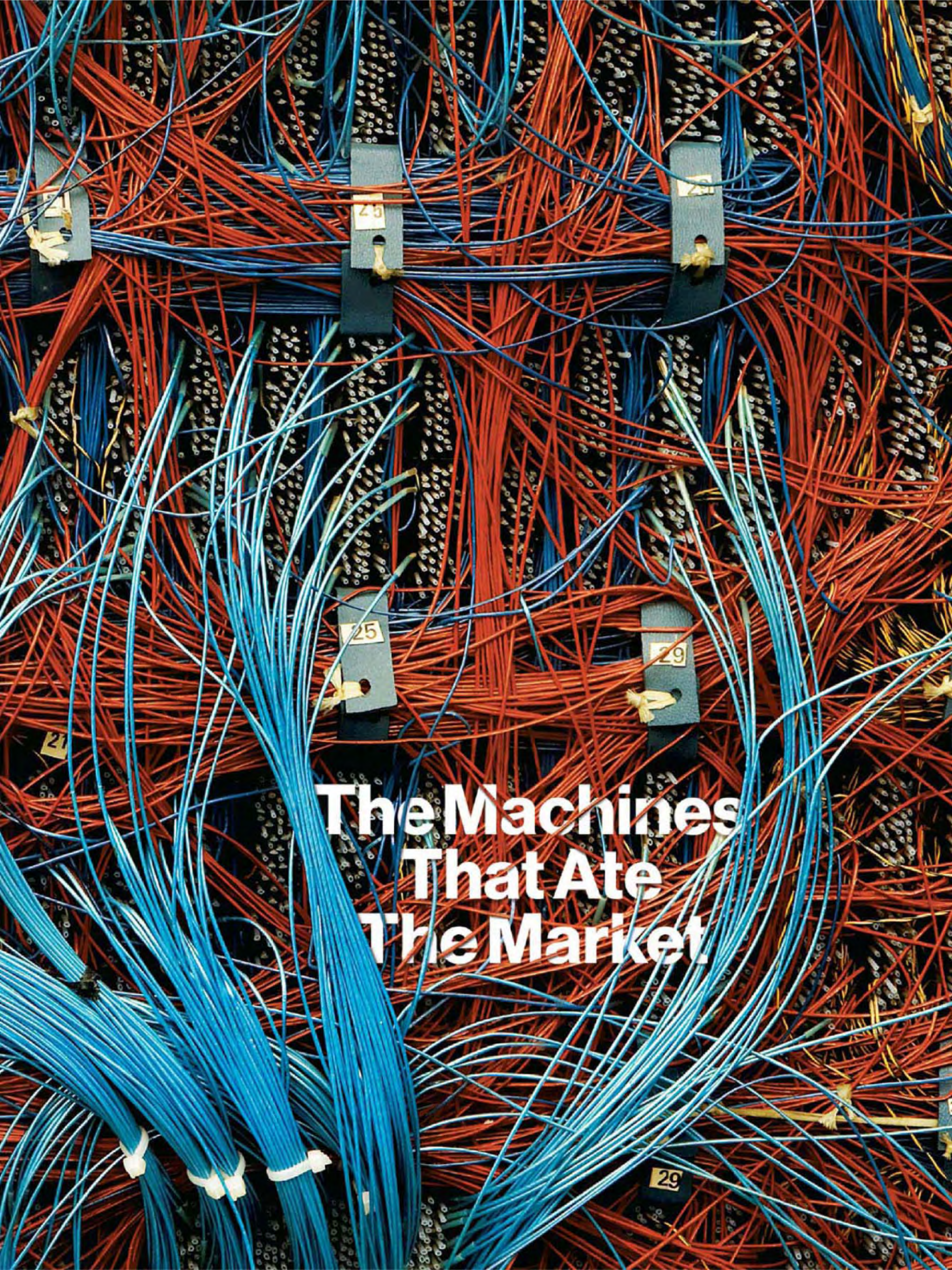
Health Care

Universal Health Services offered **$3.1 billion**, including debt, for Psychiatric Solutions, in the largest health-care services deal of 2010. The acquisition will more than double UHS's revenues from mental health operations, which last year totaled **$1.3 billion**.



Once upon a time, human beings oversaw the trading of stocks. They've been replaced by a complex system of computers that can produce a scary new kind of mechanized panic. An investigation into the crash of May 6

By Nina Mehta, Lynn Thomasson, and Paul M. Barrett



The Machines That Ate The Market

Clarence Woods was attending a community college near Baltimore in 1982 and playing drums in a wedding band when one day, to his surprise, the financial world beckoned. "They were so desperate for anyone who knew anything about computers," Woods recalls. "If you could spell the word, you had the job." He swiftly moved from the back office at the brokerage Legg Mason to Equitable Bank, where he installed Quotron stock price machines. In 1985 he made his first purchase as a rookie trader: 100 shares of IBM on the New York Stock Exchange.

On May 6, Woods, now 47, realized how radically his industry has changed. He had just started his own hedge fund after quitting as chief equity trader at MTB Investment Advisors, a $13 billion money manager in Baltimore. He was working at home when the trouble hit. "I was doing some small trades, and had a lot of puts set up, and all of a sudden they just went berserk," he says. "Then I started to panic."

His first thought was that cyber-savvy extremists had infiltrated the fiber-optic network on which automated programs now trade securities tens of thousands of times a second. With no terrorism reports surfacing, Woods shifted his suspicion to the nature of the contemporary market itself: hyper-accelerated, decentralized, and, in important ways, beyond human supervision. "I thought, 'My God, I bet you're sure going to miss the New York Stock Exchange now.'"

A lot of people felt nostalgia for Big Board dominance on May 6. The fleet computers that drive today's securities industry are astounding–and unsettling. "Wall Street is no longer what it was designed to be," Mark Cuban, the tech entrepreneur, veteran investor, and owner of the Dallas Mavericks basketball team, blogged after watching the frantic selloff. "Wall Street is now a huge mathematical game of chess where individual companies are just pawns."

Hysterical Thursday did no apparent long-term harm. Some venerable stocks dropped to a penny apiece before bouncing back. Overall, the Standard & Poor's 500-stock index declined 6.2 percent, from 1,136.16 to 1,065.79, in a 20-minute span–an $862 billion paper loss–before recovering to finish down 3.2 percent.

Still, the brief crash threw up a flare that illuminated a financial topography that was unfamiliar even to many experienced investors. A *Bloomberg Businessweek* investigation into those harrowing minutes revealed the extent to which the market is now dominated by quick-draw traders who have no intrinsic interest in the fate of companies or industries. Instead, these former mathematicians and computer scientists see securities as a cascade of abstract data. They direct their mainframes to sift the information flows for minute discrepancies, such as when futures contracts fall out of sync with related underlying stocks. High-frequency traders (HFTs), as they're known, set an astonishing pace. On May 6, 19 billion shares were bought and sold; as recently as 1998, 3 billion shares constituted a very busy day.

The HFT wizards argue that all that extra buying and selling provide the liquidity that makes the market more efficient. As long as the machines are humming, electronic bids and offers abound. On May 6, however, we saw what happens when digital networks follow conflicting protocols and some of the mighty computers temporarily power down. Liquidity evaporates. Panic combined with automation leads to much faster panic.

The decline began midmorning as skittishness intensified over the Greek economic debacle spreading elsewhere in Europe. A closely watched gauge of volatility calculated by the Chicago Board Options Exchange hit a high point for the year at 2:08 p.m. The volatility index, or VIX, is derived from options on the S&P 500, and it measures investor perceptions of market risk. When the VIX surged again, in its biggest gain in three years, some high-frequency programs may have automatically slowed their normal pace to limit losses, according to a May 15 research note by Nomura Securities.

Sell orders piled up much faster than buys, an imbalance that worsened over the next hour. During the period of heaviest selling, starting around 2:30 p.m., the NYSE paused electronic trading in certain stocks and switched to computerized auctions conducted by human traders. This caused electronic sell orders to be rerouted to other trading venues, where there were few, if any, buy orders to absorb them. As Mary L. Schapiro, chairman of the Securities & Exchange Commission, put it in congressional testimony five days later, some

PREVIOUS SPREAD: MARK RICHARDS; BELOW, FROM LEFT: COURTESY OF NEW YORK STOCK EXCHANGE ARCHIVES/NYSE EURONEXT; COURTESY OF THE THOMAS A. EDISON PAPERS AT RUTGERS UNIVERSITY; MARY EVANS PICTURE LIBRARY/THE IMAGE WORKS; IMAGNO/ULLSTEIN BILD/THE GRANGER COLLECTION

Tricks of the Trade

The evolution of men and machines in the stock market

1792

Birth of the New York Stock Exchange

Twenty-four brokers and merchants assemble on Wall Street to sign the Buttonwood Agreement and begin trading securities on a commission basis.



1867

Arrival of the ticker

Invented by Edward A. Calahan, the new device transforms the stock market by making current prices available to investors far from Wall Street.



1871

Rise of floor specialists

To foster continuous trading, the NYSE adopts a system of brokers responsible for particular stocks who remain at set locations on the floor.

A Wild Ride

The S&P 500 on May 6, 2010: One big dip and a bit of a bounce

Up	Down	Down	Down	Up	Down	Up	Up
10:05 a.m.	noon	2:08 p.m.	2:23 p.m.	2:30 p.m.	2:46 p.m.	2:47 p.m.	2:54 p.m.
1,167.58 points	**1,154.49** points	**1,141.26** points	**1,131.49** points	**1,133.05** points	**1,065.79** points	**1,072.70** points	**1,120.13** points
Stocks initially rise, hitting their high point at 10:05 a.m. before turning negative 15 minutes later	Losses continue through midday in reaction to unsettling news about spreading European debt crisis	The VIX, a gauge of stock volatility, climbs to its highest level of the year as equity losses deepen	Sell-off accelerates, with the S&P 500 down 3 percent; Nasdaq exchange issues alert about anomalous prices	Chicago Board Options Exchange announces it will disregard quotes from electronic NYSE Arca exchange; Nasdaq soon follows suit	In just 14 minutes, S&P plunges 5.7 percent to day's low as NYSE suspends electronic trading and orders cascade elsewhere	In one illustration of mounting chaos, Procter & Gamble shares suddenly fall to $39.37 from $56.32	In less than 8 minutes, the market bounces back 46 points; it closes down 3.2 percent at 1,128.15

high-frequency firms "withdrew their liquidity after prices declined rapidly."

During the next few hours of confusion, exchanges began canceling trades in hundreds of stocks. NYSE Arca, an electronic platform operated by the Big Board, erased transactions in 295 companies. A surge in trades rejected by exchanges constitutes another trigger that automatically causes some high-frequency firms to slow down, says Ethan Kahn, a principal at Wolverine Trading, an electronic market-making outfit in Chicago: "You disable. You shut down." Wolverine pared back activity in equity futures because of concerns about the accuracy of data it was receiving, he adds.

In Washington, the staff at the SEC began reviewing up to 10 terabytes of market data to figure out what happened. Twelve days later, on May 18, the agency conceded that it still couldn't offer a firm answer. That uncertainty in itself suggests the disquieting complexity the stock market now presents.

The SEC and the Commodity Futures Trading Commission issued a preliminary report in which they outlined six hypotheses that could explain the scare. "We continue to believe that the market disruption of May 6 was exacerbated by disparate trading rules and conventions across the exchanges," Schapiro said upon the report's release. As one response, the SEC proposed that exchanges halt trading in individual stocks that swing more than 10 percent during a five-minute period. The new "circuit breaker" rules are subject to commission approval after 10 days of public comment.

While temporarily slowing trading during periods of investor high anxiety makes sense to regulators, at least some high-frequency traders disagree. "I don't think that's the right solution," Wolverine's Kahn told Bloomberg News after the SEC announcement. "It could cause a lot of complications. On a busy day where the market is making major moves, you'd have a handful of [stock] names where it's circuit breaker-on/circuit breaker-off all day."

As this debate unfolds, one danger is that regulators, politicians, and industry executives—already distracted by how to reform Wall Street in the wake of the broader credit crisis of 2008—will shrug off May 6 as a weird blip requiring no fundamental rethinking of how man, machine, and market

1878

Installation of telephone

Two years after Alexander Graham Bell's first successful tests in Boston, the stock exchange improves communication with its first phone.



1923

Fraud Bureau established

Early in the Roaring Twenties, the NYSE establishes an office to sniff out gamblers who bet on the rise and fall of the stocks and undermine investor confidence.

1929

Black Tuesday jolts the markets

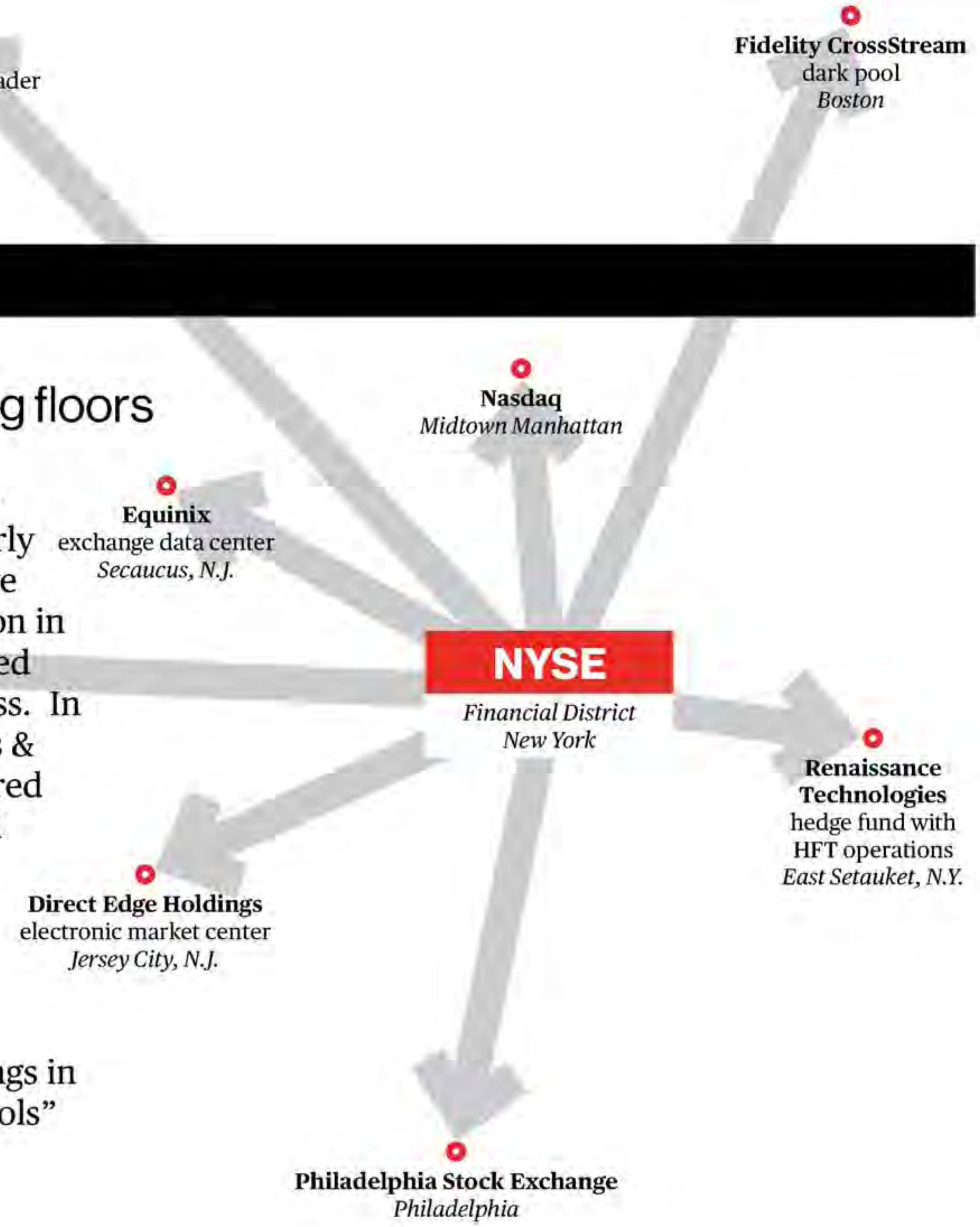
On Oct. 29 the Dow Jones index falls more than 11 percent, erasing some $8 billion in value; during the Great Depression, stocks decline 89 percent.



The Market Diaspora

Today's decentralized, virtual trading floors

Ever since the "curbstone brokers" set up shop outside the New York Stock Exchange in the early 1800s, venues for trading shares in the U.S. have proliferated. Computerization in the 1970s and 1980s facilitated the dispersion of the business. In the late 1990s, the Securities & Exchange Commission adopted rules that spurred competition in Nasdaq stocks. That fragmented the industry even further. Now the U.S. stock market is actually a network of 50 different venues connected by an electronic system of published quotes and sale prices. In addition to the NYSE and Nasdaq, trading occurs on electronic platforms such as Direct Edge Holdings in Jersey City and on dozens of so-called "dark pools" such as Fidelity's CrossStream in Boston.



interact. Absent so far from the public discussion is any talk about whether the next quickie-crash might coincide with an outside event that shakes investor confidence much more severely: Iran and its nukes, industrial-environmental disaster, North Korean aggression. Or all of the above.

As we just saw when major investment banks suffered blindness to the toxic effects of mammoth leverage, exotic credit derivatives, and a nationwide housing bust, Wall Street's computer models tend to fail when unpredictable disasters overlap.

For generations, the Big Board played the vital role of estab- lishing prices for most major stocks. Even after rudimentary computers arrived in the 1960s, living, breathing people continued to supervise the proceedings. Beginning in the 1970s, Nasdaq, and, later, additional electronic rivals, gradually eroded the NYSE's dominance. Humans could intervene if things got too strange.

That has changed. Today, hedge funds and HFT shops move enormous quantities of stock in fractions of a second. Firms jockey to place their computers near the mainframes of wholly automated trading venues you've never heard of in Jersey City, N.J., and Kansas City, Mo. The speed-of-light traders do this because the distances that their orders travel, measured in feet, can determine profit or loss.

Directives from Washington have encouraged the dispersal of trading. Some 50 exchanges and other electronic venues across the country now compete for securities business. The volume

1934

Securities & Exchange Commission formed

The agency's two primary purposes are providing investors with greater disclosure and policing fraud in securities sales.

1961

Fragmentation fears surface

Congress authorizes the SEC to study the decentralized over-the-counter market; the agency suggests improved automation.

1966

Trading floor automated

After years of hesitation, the NYSE moves into the age of computerization; human traders continue to make all crucial decisions.



1971

Nasdaq launches operation

The National Association of Securities Dealers starts its automated system with median quotes for 2,500 over-the-counter securities; NYSE now has real competition.

of equity traffic controlled by the NYSE fell from 80 percent in 2005 to 50 percent in 2007 and then to less than 25 percent this year. The exchange floor swarming with brokers in colorful jackets has become little more than a theatrical backdrop for cable TV correspondents.

The vast majority of the action occurs elsewhere. High-frequency traders now account for as much as 60 percent of daily volume, according to Tabb Group, a research firm. The most prolific HFT outfits, such as Getco in Chicago, Tradebot Systems in Kansas City, Mo., or RGM Advisors in Austin, Tex., can individually generate as much as 5 percent or 10 percent of all the stocks traded in the U.S. on a given day.

"The world has totally changed in the last 15 years," says Fred Federspiel, who started Pipeline Trading Systems in 2004. Pipeline, based in New York, belongs to yet another new breed: "dark pools" that allow major trades to take place out of public view. Before getting into finance, Federspiel, who holds a doctorate in nuclear physics, worked at Los Alamos National Laboratory in New Mexico, using particle accelerators to determine if subatomic neutrinos help hold the galaxy together. Trading models built by people with this sort of training tend to be based on a view of the market that is data-driven and news-agnostic.

Wall Street's extreme makeover has achieved its main goals: greater efficiency and much lower commissions for the pension and mutual funds, insurance companies, and endowment managers that invest in equities. Reduced transaction costs benefit teachers, office workers, corporate executives, and retirees from coast to coast.

At the same time, the transformation has created new risks, some of which were momentarily perceptible on May 6. "What happened [that day] is completely unacceptable," says Richard Gorelick, RGM's chief executive officer. Gorelick, who formerly helped run the Internet company Deja.com, turned 39 on May 6. "I got a lot of birthday calls," he says, "followed by, 'What the hell happened?!'"

Manuel A. Henriquez is no Luddite. He has invested in technology companies for 23 years and runs Hercules Technology Growth Capital, a publicly traded venture firm in Palo Alto, Calif. On May 6 he gaped as Hercules shares fell from $9.50 to $5.22 in less than 33 minutes. The 46-year-old father of two girls, ages 12 and 10, has $6 million of his own money tied up in Hercules. For a while that afternoon, he thought he had lost half of it. "I literally called my wife and said, 'Give the kids tennis rackets; they're going to have to get scholarships.'"

Hercules shares closed on May 6 at $9.56 after trading at twice their normal volume. If the Henriquez girls take up tennis, it will be for the love of sport. Still, their father remains shaken. "It's like the movie *2001: A Space Odyssey*," he says. "You can't have Hal the Computer make all the decisions for you. We need to synthesize the human element of logic and say, 'Wait a minute, I've got an order that has never been of this size. This seems to be an anomaly.'"

When Henriquez started investing in the mid-1980s as a college student in Boston, he set aside $20 or $30 a week to buy shares. In that era, broker Richard Rosenblatt and his breed still had tremendous influence over the running of the Big Board, and, by extension, over the entire market in stocks. "I was much younger and pretty quick," Rosenblatt says. "I was the high-frequency trader at the time."

Rosenblatt Securities, launched in 1979, executes buy and sell orders for mutual funds and other money managers. When carrying out trades back then, Rosenblatt could see everyone he was dealing with. Specialists positioned at designated posts on the floor "made markets" in stocks they were assigned. They had the responsibility of buying even when a company's shares were falling. Big investors relied on their brokers to buy low and sell high. Unscrupulous traders could–and sometimes did–put their own interests ahead of those of their clients. Aside from exchange rules and the remote danger of prosecution, the trust among brokers and specialists provided the main impediment to fraud.

Four years before Rosenblatt started his company, though, Congress had signaled that the era of traditional markets wouldn't last forever. Lawmakers directed the SEC to reduce the NYSE's near-monopoly and replace it with "a national market system." The goal: greater competition and lower expenses for investors. Rosenblatt embraced electronic trading and survived. Many of his cohorts did not.

The SEC banned fixed minimum commissions and imposed rules that strengthened the upstart Nasdaq, which had begun operations in New York in 1971. Improved technology contributed to rising volume. Much of the additional trading was generated by firms using computer software to identify momentary pricing discrepancies, as opposed to longer-term investors hunting for corporate value. In the 1980s, "program traders" bought or sold large portfolios of securities in a single

FROM LEFT: UNDERWOOD ARCHIVES; COURTESY NEW YORK STOCK EXCHANGE ARCHIVES/NYSE EURONEXT

1975
Fixed commissions abolished
The SEC bans fixed minimum commissions on trading, after which rates fall dramatically and volumes surge.

1982
NYSE has first 100-million-share day
Fourteen years later, Big Board trading volume reaches 1 billion shares during a single day; that figure tops 2 billion by 2001.



1982
National Market System established
The NMS is launched to provide up-to-the-minute information on Nasdaq's 40 highest-volume securities.

1984
Small Order Execution System begun
SOES automatically executes small orders against the best quotations, increasing efficiency and volume; "SOES bandit" arbitragers game the system.

Mid-1980s
Spread of program trading and portfolio insurance
Program traders use software to buy or sell portfolios of securities in a single order while making offsetting bets on futures; portfolio insurance is sold as a risk management tool.

order, while simultaneously making offsetting bets on related futures contracts. Designed to hedge risks, program trading at times contributed to greater volatility. On Oct. 19, 1987, it helped accelerate the Black Monday market crash.

Historically, the NYSE and Nasdaq were nonprofits seen as utilities that served the public interest in matching investor resources with corporate enterprise. They evolved into for-profit corporations fighting for survival. Newer profit-making exchanges started explicitly to benefit the firms that ran and patronized them. "They're more competitive, more self-serving, and they've moved more away from the utility concept," says Rosenblatt. "Maybe it's gone too far."

SEC rule changes adopted in 1998, 2005, and 2007 aimed at ever-lower transaction costs by encouraging formation of electronic communication networks, or ECNs, that challenged the NYSE and Nasdaq for market share. Robert Colby, who oversaw the modernization process for 15 years as deputy director of the SEC's Trading & Markets Div., says the march of technology was irresistible. "Electronic trading allowed new automated markets to spring up and compete head-on with established exchanges and market makers," he says.

David Leinweber, a finance professor at the University of California at Berkeley, helped create one of the first algorithmic trading strategies in 1989. Originally called Market Mind, it allowed computers to execute securities orders entirely on their own. Leinweber had studied math and physics as an undergraduate at the Massachusetts Institute of Technology. His preparation for the Market Mind breakthrough also included research he had done at the government-funded RAND Corp. think tank. There, he helped improve communication systems and real-time data analysis for the space shuttle. In the late 1990s he worked as a partner at First Quadrant, a Pasadena (Calif.) investment firm. "I was managing equities all over the world at that time," he says, "and pretty soon there were just no [trading] floors to visit. You switched to trading electronically."

Digital networks such as Island ECN and Archipelago usurped the human trading floors by offering rebates on trading and faster execution. These innovative virtual trading sites lacked the cadres of specialists and market makers obliged to maintain orderly trading. In their place were "liquidity providers"–brokerages willing to post electronic bid and ask quotes, but free of institutional duties.

Seemingly minor advances had profound consequences. The switch in 2001 to decimal share pricing, from sixteenths of a dollar, gave investors greater flexibility. Any firm willing to sell for a penny less than the best available offer price could step in and make the trade. A traditional Nasdaq market maker that had bought at $10 and sold at $10.0625 found itself in a lower-margin business. This favored the new electronic communications networks and the ever-speedier high-volume traders seeking microscopic profits across a multitude of transactions.

Market making moved from exchange floors to computers. On its Web site, Wolverine in Chicago says its servers receive direct data feeds from more than 15 exchanges and execute more than 1.5 million orders a day. The culture of the industry changed, too. Membership on a college sports team no longer constitutes a ticket to an entry-level job. In the past, Wall Street traders "were taller, bigger, more aggressive," says Kahn, who oversees market making at Wolverine. Today's HFT firms, by contrast, look for "more of a quant-computer-type person," says Kahn, who has a finance degree from the Wharton School.

The quants use a range of strategies. One is simultaneously posting bids and offers for ever-changing amounts of a single stock. Prices tend to vary by minuscule amounts on different electronic exchanges, so a stock can be bought at a lower price on one, then sold instantly at a higher price on another. The profit could be as little as a hundredth of a cent per share, which, multiplied by millions of shares a day, adds up to real money.

One thing that apparently happened on May 6 is that when HFT firms reacted to the market's sudden moves by slowing their computers or switching them off, buy orders that had been in place only seconds earlier disappeared, causing disequilibrium. HFT behavior, to be sure, wasn't the only factor that turned a down day in the markets into an abrupt collapse. Conflicting rules among exchanges also played a role.

RGM's Gorelick says his HFT firm, founded in 2001, continued to trade during the market turmoil. Its software developers and IT support people crowded onto the trading floor in Austin and quietly stared at the computer screens. Gorelick says, however, that high-frequency buying and selling wasn't so much the problem. He blames "old-fashioned human panic," worsened by inconsistent policies among exchanges.

Kahn disagrees. "The system broke down" on May 6, he says. "There should be and will be structural changes in the future." New regulation is coming, he adds. "We just don't know what it will be."

Schapiro has said she hasn't assessed any blame yet. HFT

TOP, FROM LEFT: DOUGLAS ADESKO; SASHA BEZZUBOV (2); KYOKO HAMADA, ALL FOR BLOOMBERG BUSINESSWEEK. BELOW, FROM LEFT: MARIO CABRERA/AP PHOTO; MONIKA GRAFF/THE IMAGE WORKS; TIMOTHY A. CLARY/AFP/GETTY IMAGES

1987

Black Monday shocks the market

Dow Jones drops 508 points, or 23 percent, on Oct. 19, the greatest one-day decline in history; program trading and portfolio insurance are contributing factors.



1987

Rise of the crossing network

Two months after the October crash, Reuters subsidiary Instinet establishes an electronic platform to match institutional orders at the closing price on NYSE and Nasdaq.

1996

A human-free network

Island ECN is founded as the first all-electronic communication network without market makers; brokerages enter a trade into the computer, and if it matches an available order, stock is bought or sold.

1998

Upstarts are unleashed

SEC adopts Regulation Alternative Trading Systems, which encourages the formation of new electronic trading systems that compete with NYSE and Nasdaq.

2001

Decimalization becomes the rule

The move in 2001 to list prices in pennies rather than dollar sixteenths cuts the gap between bid and ask quotes and reduces profits for market makers.

The Human Element

Traders who coexist with the bots on Wall Street






Manuel Henriquez of Hercules Technology Capital Growth; Rosenblatt Securities' Richard Rosenblatt; Pipeline Trading Systems' Fred Federspiel; and Clarence Woods, formerly of MTB Investment Advisors

firms that pulled back may have acted appropriately, given that they had no legal obligation to do otherwise, she told Congress. In addition to its circuit-breaker proposal, the SEC is expected to consider requiring high-frequency traders to continue to make markets, even during a major selloff.

Some would resist such a mandate. "No one should be forced to provide liquidity when CNBC is showing riots in Greece in the morning and there are worries the bailout of Greece and Portugal will fall apart and they'll default on their debt," says Pipeline's Federspiel.

On another front, some lawmakers have proposed enacting a tiny tax on each equity trade. Such a levy would likely discourage some high-frequency trading, slow the market's pace overall, and raise billions in revenue for the federal government. Some of the tax proceeds could be used to bolster SEC monitoring.

After the frenzy of May 6, Clarence Woods of Baltimore says he ended up more or less where he started. He's moving ahead with plans for his new hedge fund and counts on the SEC to reassess the market: "We'll sit back, see what works and what doesn't." Manuel Henriquez, the Palo Alto venture capitalist, acknowledges "a visceral reaction to pull all the computers out." He doesn't think that's feasible, though. "We need to continue to embrace technology, but understand that technology can bite both ways."

Matt Andresen helped launch Island ECN in 1996 and later oversaw market making at Citadel Investment Group, which he left in March 2009. "The impact of the high-frequency tool has been, I believe, very democratizing," he says. Brokers serving individual investors can execute orders more quickly and less expensively—at least on most days. Then there was May 6. "Whatever the cause of it," Andresen says, "the failure mode was unacceptable." B

—With Jeff Kearns, Whitney Kisling, and Peter Coy

2005

More competition

SEC acts again, with Regulation National Market System, which aims to provide customers with best prices by fostering yet more competition among markets.

2008-present

High-frequency trading mushrooms

Hedge funds and proprietary trading firms use superfast computers to profit from massive trades taking advantage of price discrepancies among exchanges.



5/6/2010

An afternoon of vertigo

The Dow momentarily falls 9.2 percent, the largest intraday plunge since 1987; factors include high volumes of computerized trading triggered by a European debt crisis.



PAYDAY NATION

How lending to people against their future paychecks went from a single shack to a strip mall staple more plentiful than McDonald's.

By Gary Rivlin. Photographs by Q. Sakamaki

Allan Jones wasn't looking to kick-start an industry when he flew his single-engine Piper Saratoga from his home in Cleveland, Tenn., to Johnson City in the spring of 1993. He only wanted to persuade a man to come work for him. Jones took over his father's small collection agency when he was in his early twenties and built it into a multicity behemoth—"the largest in Tennessee," he'd tell you. But it gnawed at him that nearly two decades later he had no presence in the northeast corner of the state. So when he heard that James Eaton, an old friend of his father's, had been let go after years in the business, Jones jumped into his plane to go get his man.

Eaton was stately, a 56-year-old who wore glasses and smoked a pipe. "He looked to me kind of like Sherlock Holmes," Jones recalls. That made it all the sadder when Jones found Eaton working out of an office in a dilapidated gas station. There, in a shack with paint peeling off the walls, Eaton had set up a meager-looking business called Check Cashing Inc. "I guess I've found myself my man in northeast Tennessee," Jones told himself.

Sitting down to talk with Eaton, Jones discovered that the business was different than he thought. Eaton was loaning cash to people who needed a bridge until the next payday. The school janitor who needed $100 today, Eaton explained, would pay him back $120 when he received his next paycheck.

Jones had built a successful debt collection business with around 250 employees—but he didn't enjoy it. Debt collection meant unhappy people. Watching Eaton run his payday shop and interact with his working class customers, Jones was struck by how friendly it all was. "People would thank him," Jones says. "They would thank him and thank him and thank him."

Jones wondered about the fee Eaton was charging. Wasn't 20 percent too steep for a short-term loan of maybe a week or two? Not really, Eaton explained, if you considered their banks would charge them at least that much on a bounced check.

Eaton declined Jones' job offer—"This is the happiest business I've ever been in," he told Jones, who took away something much more valuable than a new employee. He decided to make a small bet on going into this business for himself. Ten grand, he concluded. He would set aside $10,000 and give it a shot.

Neither Eaton nor Jones invented the payday loan. Moneytree, a check-cashing firm on the West Coast, and QC Holdings, a check cashier that originated in Kansas City, Mo., both offered cash advances to customers starting in the late 1980s. But Jones was the first to pursue the cash advance as a stand-alone business with blue-sky potential. "It was like we was filling this giant void out there," he says.

To most people, it looked like a shaky proposition—how likely is it that the customer who can't muster $300 today is going to scrape together the $345 two weeks later to pay off a loan? The key is that she doesn't necessarily have to. The bulk of revenues comes from customers who roll their loans over for weeks, if not months, at a stretch. In 2001 the industry passed the 10,000-store mark and entrepreneurs with national ambitions were still lined up at the door, hoping to get in. At the industry peak, in 2006, there were 24,000 payday stores in the U.S., according to Stephens, an investment bank in Little Rock that has carved out a specialty in subprime businesses. That was more than all the McDonald's and Burger Kings combined.



Jones rules his company with impunity: "I win every vote one to nothing"

Jones, 57, stands maybe five foot eight. He's bald with a full beard, and resembles the director Rob Reiner, minus the liberal politics. He still lives in his hometown of Cleveland (pop. 37,000). On our first of two full days together, he wore scuffed cowboy boots and a monogrammed white dress shirt with his belly hung over frayed jeans like a proud accessory. He personally clears $20 million a year from the payday business.

Jones spent a year at Middle Ten-

Excerpted from *BROKE, USA: From Pawnshops to Poverty, Inc.—How the Working Poor Became Big Business* by Gary Rivlin. Copyright (c) 2010 by Gary Rivlin. To be published on June 8, 2010, by HarperBusiness, an imprint of HarperCollins Publishers.



Check Into Cash opted to invest in more scuzzy locations—rather than fewer good-looking ones—throughout Tennessee


Jones' palatial house under construction in Cleveland, Tenn.

nessee State University in Murfreesboro before dropping out to work at his father's credit agency. By then, his father, suffering from emphysema, was able to work only a few hours each day, and a rival credit agency had opened in town. "Come home and save the business," his mother asked him, "so we can afford to send your two sisters to college."

Jones didn't need much convincing. He had married his high school sweetheart, who was pregnant with their first child. They were living in a trailer. On his first day on the job, Jones thought his father might have lost his mind. He had recently hired a new manager, but he let him go and announced to Jones, then 19, "You're in charge, son."

The son gamely settled in and began to crack the whip like an old pro. He figured out the average collection agent made 25 calls a day; by his reckoning, a person should reasonably make a new phone call every five minutes. So he imposed a quota of at least 100 calls per day per person. "After that the company really took off," he grins.

Jones was 24 when he bought out his father for $100,000 and named himself chairman, president, and chief executive officer of Credit Bureau Services, a company that he would sell for more than $10 million in 1998. His payday business was starting to move, he explained, and he had decided "to really throw the hammer down."

Three weeks after visiting James Eaton in Johnson City, on the first day of summer 1993, Jones opened Check Into Cash. His first customer was a military man who needed $100 to buy a bicycle for his daughter's birthday. Not long after opening that store, he opened a second 30 miles away. As an experiment, he put a childhood chum he describes as a "lump on the log" in charge of the operation. It made no difference. That store made money just as rapidly as the first. Lawyers from a big firm in Chattanooga advised him that there was nothing in Tennessee law expressly forbidding him from making these high-rate, short-term loans, and he opened seven more stores around the state in 1994. He collected nearly $1 million in fees that year; the stores, including salaries and bad debt, cost only $486,000, leaving him with more than half a million in profits.

To open new locations, Jones hired Steve Scoggins, a local man he had known since they were kids, and gave him a budget of $1 million. After doing some research, Scoggins asked him, do you want 20 good-looking stores or 60 that don't look so nice? Jones chose the 60. In 1995, Check Into Cash generated nearly $1 million in pretax profits on $3.7 million in fees, operating stores in Tennessee, Kentucky, and Indiana.

To grow his payday empire, Jones needed capital, but he had difficulty persuading traditional bankers to do business with him. In the '90s, at least, they were squeamish about venturing into the world of fringe financing. One of the first big chunks of cash he got—$3.5 million from a private equity firm—cost Jones a payday-like interest rate of 14 percent. Check Into Cash opened more than two stores a week through 1997. Jones secured an additional $11 million line of credit from NationsBank at the end of the year, allowing him to open an average of three stores per week through the first half of 1998.

The company hired a new regional manager every time it added 10 to 15 new stores. To keep everyone financially motivated, bonuses were granted based on the performance of those directly below them on the organizational chart. Store managers, who tended to have a year or two of college on their résumés, were flown to the mother ship in Cleveland for four days of intensive training. While there, they were given a policy manual that they were instructed to treat as if it were handed down from the mountaintop. It spelled out in intricate detail the most mundane of tasks, from the proper storage of bank receipts to the number of times a day a manager should phone a bank to see if a customer's postdated check (the check a customer had written when initially taking out the cash advance) was good.

In time the company perfected a system for finding new locations. The Holy Grail was a shopping center anchored by a Wal-Mart, perfectly placed for when people needed cash to go shopping. A storefront close to a Kmart or Kroger was also a guaranteed winner. Trial and error taught Jones that he should cluster stores, which allowed for better oversight and a more efficient use of marketing dollars. A new store typically generated enough cash to cover the initial startup costs by the ninth month in business.

Early on, Jones was cautious about how much he would lend a borrower. Gradually he loosened the guidelines, and by the late '90s the company established the lending standard it uses today: A person can borrow as much as one-quarter of his or her monthly paycheck. Predictably, that increased the number of people unable to pay their loans; the percentage of loans the company wrote off doubled from 2 percent in 1993 to 4 percent in 1998. But the company's financial statements from that period show that the increased revenues easily covered the increased losses. Check Into Cash more than doubled its revenues 1998, with profit margins well above 20 percent. That's about when Wall Street dropped any qualms it might have had about payday lending.

Jones loved hosting the investment bankers who began visiting him. He would greet them in an off-the-rack suit he bought at a discount place in town, then usher them into his "conference room"—10 metal chairs around a banged-up, folding banquet table. Nobody minded. "Them numbers are all they ever noticed," he says.

CIBC Oppenheimer initially agreed to serve as the lead underwriter on Check Into Cash's initial public offering, set for 1998. When CIBC put the IPO on hold while the market recovered from the so-called Asian flu, Jones refused to wait. The competition was heating up, and he was anxious for his money. So he persuaded officials at National City, then awakening to the profit potential of subprime, to loan him the $50 million he'd planned to raise through an offering. He liked the idea of keeping his independence. "We have board meetings at Check Into Cash," Jones likes to joke, "but I win every vote one to nothing."

PREVIOUS PAGE: COURTESY OF UT (JONES); THIS PAGE: COURTESY OF BING MAPS

While Jones had taken a tiny idea and made it big, it took another entrepreneur with lots of money and political connections to usher it into the corporate mainstream. His name is Billy Webster, and he first got rich on fried chicken. While studying law at the University of Virginia in the early '80s, his father started talking about the long lines of people queuing up at the local Bojangles' chicken shack. That marked the end of young Webster's legal career. "I graduated law school on a Saturday, and Monday night I'm in the back of a Bojangles learning how to fry chicken, being taught by a 16-year-old black guy from Frogmore, S.C.," says Webster.

Ten years later, Webster and his father sold their holdings back to Bojangles; the pair were operating two dozen stores generating a combined $24 million in annual sales. By almost any standard, if not his own, Billy Webster was a rich man.

For a time Webster got into politics, including a stint as the chief of staff for Richard Riley, the ex-South Carolina governor named Secretary of Education by Bill Clinton, and did a year as a scheduler for Clinton himself. When Webster returned to South Carolina, he was determined to find a business that he enjoyed running. "Basically, I was looking for a consumer service business [that] was mom-and-pop-dominated," he says. "I was looking for an industry that hadn't been professionalized."

When he first heard about the payday business in 1996, Webster liked the sound of it so much that he flew to Tennessee to work a few weeks behind the counter of a Jones competitor called National Cash Advance. "I didn't see an unhappy human being in my three weeks working there," says Webster.

He came away from the experience planning to dominate payday lending in the fashion of Wal-Mart. For additional backing, he went to George Dean Johnson Jr., an old family friend who had opened more than 200 Blockbuster video rental stores before selling them back to the parent company for $156 million. Webster showed Johnson two lines on a piece of paper–one showed the cost of a payday loan, the other the rising costs of a bounced check or credit-card late fee. "When those lines crossed," Webster explained to Johnson, and the bank penalties started costing more than the short-term quick loans, "the industry just grew and grew and grew."

Using their connections, the pair secured sizable lines of credit from Wells Fargo, Wachovia, and NationsBank to start building Advance America. "We basically borrowed $40 or $50 million before we made anything," Webster says. "We had an infrastructure for 500 stores before we had even one."

Advance America opened 300 stores in 1997 and 400 the next year. In 1999, Webster started calling rivals to see who might be interested in selling. Allan Jones took the call while soaking in a tub in his summer home and turned him down. Within a few years, Advance America had more than three times as many stores as Check Into Cash.

The political environment at the time was accommodating. In 1998, South Carolina legislators welcomed payday lenders into their state, as did elected officials in Mississippi, Nevada, and the District of Columbia. By the end of 2000, 23 states had legalized payday lending, and the likes of Advance America and Check Into Cash were operating in eight more because no law on the books forbade them to do so. Where a traditional lender was earning a return on investment of between 13 and 18 percent, according to Stephens, the average payday lender averaged 23.8 percent.

As the industry grew, opposition was inevitable–and came most vocally from Jean Ann Fox, the Consumer Federation of America's director of financial services. In a 1998 report, "The Growth of Legal Loan Sharking," Fox assailed what she originally called "delayed deposit check loans," or "check advance loans." She also injected math into the debate. As she read it, the 1968 Truth in Lending Act required any business to express the cost of a loan not only in dollar terms but as an annual percentage rate, or APR. The $15 per $100 that payday lenders could charge in stricter states like Ohio and Washington worked out to an APR of 391 percent. In Arkansas, where payday lenders could charge as much as $21 for every $100 borrowed, the APR was 546 percent. Borrowers in Indiana, with its $33 per $100 cap, were paying the equivalent of 858 percent on a two-week loan.

Webster prides himself on his ability to get along with anyone. Fox, he says, proved to be an exception. "A person says stuff like ' loan sharking,' and it's hard not to take this stuff very personally," he says. He agreed with Fox on at least one point, though: the need to state the cost of payday loans as an APR. Advance America's general counsel had concluded the same after researching the law. Webster could have overruled her, but he figured people didn't care about the APR: They only cared that they could have $300 today.

So in the late '90s, Advance America became the first chain to post its APR. Now Webster regrets it. He argues that his 391 percent APR is a meaningless number–like saying salmon costs $15,980 per ton or advertising a hotel room for $36,500 per year. A flat fee is not an interest rate. He also concedes the public doesn't see it that way. "It has been a millstone around our neck."

Despite the calamity that hit the globe with the implosion of subprime mortgages, payday lending enjoyed a robust 2009–at least in those states where it could still operate freely. Advance America's aftertax profits were up more than 40 percent over 2008; in Cleveland, Tenn., Allan Jones told me that although he has fewer Check Into Cash stores than he used to–1,200 vs. a peak of 1,300–business was brisk in 2009. Defaults were up but so was traffic, and per-store revenues were rising.

The climate, however, has changed. In Ohio, one of payday's strongest markets, voters in 2008 approved a ballot referendum that capped the rates a payday lender could charge at 28 percent annually. In Arizona, voters overwhelmingly supported a ballot initiative that in effect kicked payday lenders out of the state, and that followed on the heels of legislative changes in Oregon and New Hampshire. "I don't know what's changed that suddenly I'm evil," Jones says. Ⓑ

"A person says stuff like 'legalized loan sharking,' and it's hard not to take this stuff very personally"
Billy Webster,
Advance America CEO

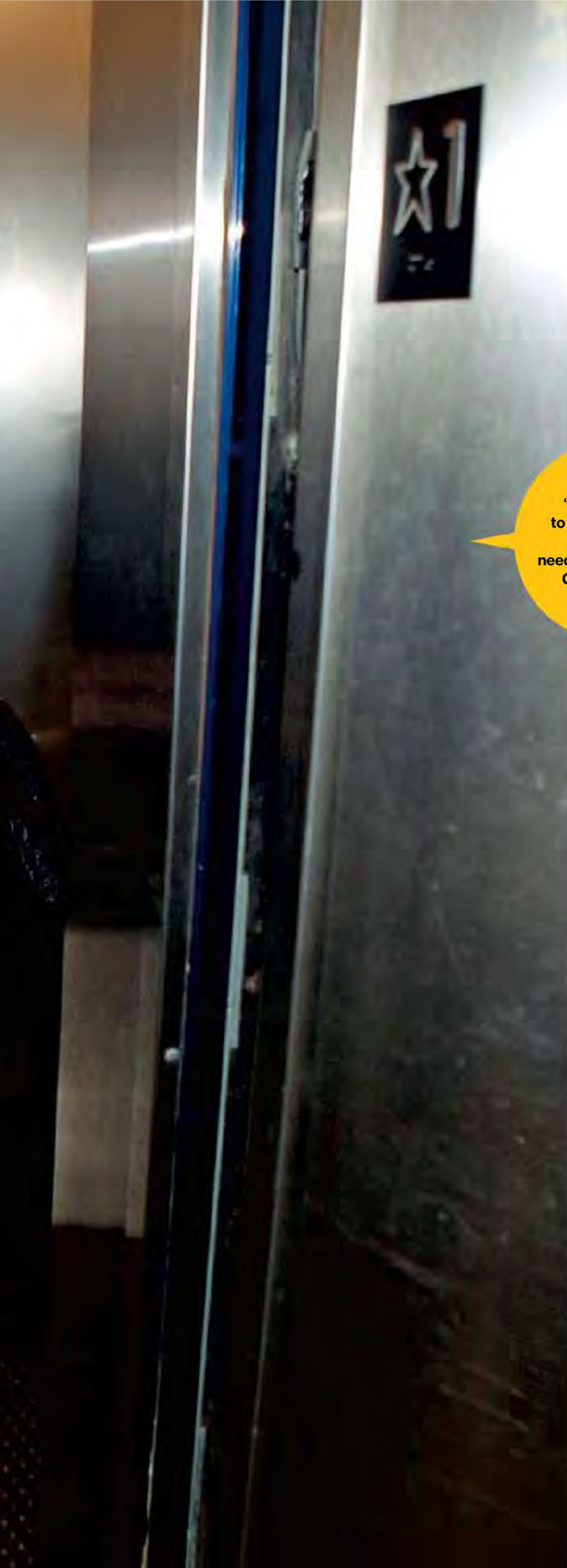


The New Star of Sellavision

When Mindy Grossman took over, HSN was selling elastic-waist pants. Not anymore.

By Susan Berfield

Photographs by Rebecca Greenfield



"I knew we had to move quickly on the things we needed to *stop* doing," Grossman says

It's 30 minutes to airtime, and Serena Williams–muscled, styled, economical in her movements–sits on a leather couch admiring her navy blue quilted flats. "These are incredibly comfortable shoes," she says. This is not the casual remark of a celebrity killing time in the green room. This is Serena Williams-as-saleswoman, practicing her pitch. Over the next 24 hours, Williams will be live on the Home Shopping Network (HSN) for a total of eight hours, hocking pieces from her clothing and jewelry collection to women across America–some 15,000 bracelets, 4,000 flats, 1,900 pairs of jeans, plus sweaters, dresses, T-shirts, and handbags. Every minute she is on air will be measured in dollars, every hour will be scripted, product by product, to build momentum. When it's over, Williams is expected to have sold all of it. On the Home Shopping Network, celebrities have to *produce*.

The fact that Williams is here at all, linking her reputation to an outlet once known for pushing Suzanne Somers' ThighMaster, shows how far HSN Chief Executive Officer Mindy Grossman has taken the company. When Grossman was recruited for the job in 2006 by Barry Diller, chief executive of HSN's then-corporate parent IAC/InterActiveCorp, she told Diller that she would accept only if he gave her the freedom to turn the place upside down. She had an impressive background, which included nine years at Polo Ralph Lauren, where she launched the Chaps and Polo Jeans lines, and six years at Nike, where she built up the women's apparel business. She wanted to transform HSN by making it more modern and tasteful: Maybe it would never be hip, it certainly wouldn't try to be edgy, but it could at least be relevant. "I got excited about what it could be, not what it was," she says during an interview at the Pierre Hotel in Manhat-

tan. "There was not a lot of pride in the culture, and that was shocking to me, especially given where I had come from."

HSN and its ubiquitous low-fi cable channel had become a symbol of American consumption gone terribly wrong. The clothes were uninspired; the beauty products didn't live up to their claims; the gadgets arrived broken. It was a second-rate version of its main competitor, QVC. "I knew we had to move quickly," says Grossman, "on the things we needed to *stop* doing."

Within her first year at the company, she dumped about a dozen brands she had never heard of. Gone were the pants with elastic waists and anything that viewers could easily find elsewhere. Then she set out to create a studio environment that wouldn't scare off the designers she hoped to feature. For that she turned to Andrew Sheldon, a British television executive. He streamlined the sets, cleaned up the green rooms, hired full-time makeup artists and hair stylists, and modulated the hosts' presentations. "Before, there was a lot of finger pointing. They spoke too quickly and too loudly," he says. "Selling doesn't mean you have to shout 'Buy it! Buy it!'"

HSN is still only a fraction the size of QVC, which had $7.4 billion in 2009 revenue. (John Malone's Liberty Media Interactive, which owns QVC, also owns one-third of HSN; under the terms of a standstill agreement that expires in August, it will have the right to buy more, or all, of the company.) But HSN is now a credible competitor, and just as important, it has achieved a measure of cultural status. "I've never tried to motivate my staff by saying we're going to be bigger than someone else," Grossman says. "I'm more a Mac than a PC."

Even during the depths of the recession, when many retailers' sales fell dramatically, HSN's grew, rising 3 percent in both 2008 and 2009. In the first three months of 2010, sales increased 9 percent, to $519 million, compared with 2009, and HSN shipped nearly 10 million items to customers. HSN's corporate parent, HSNi, which includes the shopping network and Web site as well as a separate catalog division, is a $2.8 billion business. Its stock has more than doubled in value since it was spun off from Diller's IAC in August 2008, just before the retail economy collapsed.

Grossman, 52, is sleek and stylish, and she likes to pile on the necklaces and bracelets when she dresses. If women ask her for advice about accessories, she always says: "more." She calls HSN customers, herself included, "professional shoppers." More than 80 percent of them are women, and most are over 35 and comfortably middle class. Beyond that, what they seem to have in common is a desire to be soothed by the promise that what they buy will make them feel better: It's the psychology of acquisition at its most simple. HSN broadcasts live, 24 hours a day, 364 days a year (it goes dark on Christmas) to 93 million homes. Some 5 million people make at least one purchase every year; the best customers make six or seven more.

In order to attract more power shoppers, Grossman set out to persuade a whole new type of designer to create collections for HSN. Among those who have happily, if nervously, appeared on the network as a result of Grossman's coaxing are Naeem Khan, who designed the silver sequined gown Michelle Obama wore to the President's first state dinner, and Badgley Mischka, who dressed Helen Mirren in gray silk and organza for this year's Academy Awards. Grossman promised to protect them and their brands from ridicule and to present their clothes in sophisticated settings as she exposed them to an audience far greater than they could otherwise reach. She also charmed them. "It was the force of Mindy's personality and the changing economics that persuaded designers to work with HSN," says Christopher Marangi, a media analyst at Gamco Investors. "Her impact can't be underestimated."

Ever since Isaac Mizrahi signed on with Target in 2003, all manner of luxury designers have collaborated with chains that cater to the masses. None of these partnerships compel the designers to engage so directly in the fundamental give and take of commerce as HSN does. "If they don't want to go on air, then they don't want to work with us—they're not passionate," Grossman says. "The whole idea is to bring more than just a product. It's to bring a voice. Their personality has to show through. I keep telling people that it's a trunk show in 93 million homes."

To court the fashion set, Grossman and Lynne Ronon, her head of merchandising, had to do some selling of their own. "I knew they would be concerned about their image," says Ronon, who was previously an executive at Burberry and Saks. At the beginning, meetings with potential designers were like job interviews for the HSN executives. Now, one recession and several well-publicized sold-out shows later, the power has shifted. "We say no more than we say yes," Ronon says.

Grossman asked Khan, whose sequined gowns can sell for $10,000, to create an exclusive collection for HSN in 2009. Khan then asked for the blessings of the heads of Saks and Bergdorf Goodman. "Luxury was in the doldrums," Khan says. "We were all asking: 'How do we keep our business going?' They need me as much as I need them. So they said, 'Fabulous. Just get a different name for the line.'"

For many of the designers Grossman has recruited, the stress is more acute and the concerns about image more pressing. They go on air anyway, having realized that in order to survive they must accommodate the marketplace. "Designers have to become more business-savvy, and that means tailoring assortments to specific retailers. They have to come to terms with that," says Kelly Tackett, a consultant at Kantar Retail.

When he launched Timeless by Naeem Khan on HSN in October 2009, Khan was apprehensive. "I'm not used to that kind of volume. I might [typically] cut 100 dresses, while they're

Grossman asked Khan to create a line for HSN; 7 of the 10 styles sold out in 10 minutes



PHOTOGRAPH BY REBECCA GREENFIELD FOR BLOOMBERG BUSINESSWEEK

The Hustlers of Home Shopping



Badgley Mischka
Sells: Apparel, accessories
How Much: A $499.90 snakeskin bag sold out in previews



Sean "Diddy" Combs
Sells: I Am King fragrance
How Much: All the perfume was gone in the first 60 minutes



Stefani Greenfield
Sells: Apparel, accessories
How Much: Her brand is one of HSN's most successful



Serena Williams
Sells: Apparel, accessories
How Much: Sold 1,900 pairs of skinny jeans in one day

buying 800, 1,000, 2,000 dresses. How am I going to sell all that?" In the first 10 minutes, 7 of the 10 styles of dresses, tops, and pants (priced $59.90 to $499.90) sold out. In his second appearance in March, Khan sold all 531 pieces of a silver sequin dress (price: $179.90) in 12 minutes. "The way I sell my clothes is the way I am with my wife and children," he says. "I race cars, cook, raise a family. Women love to hear that. You have a lot of pretentious designers out there. People buy your clothes because they like you."

When Grossman talks about her ambitions for HSN, she doesn't talk about a mere shopping channel. The experience, she insists, "could be empowering for the customer. She wouldn't just buy something; she would be inspired and engaged."

The source of that inspiration must be the style icons who appear on-screen. Grossman wants celebrities who are comfortable with the hustle of "sellavision," as some of them call it. She thought Williams would be a natural fit: "I knew Serena would love this and would be successful," says Grossman. "When she and Venus were kids, they used to pretend they were hosts on HSN. Even though she's a globetrotting athlete, her passion is fashion. One time I was talking her through all the fabric technology we had at Nike, and she said, 'Mindy, I really just care that it looks great.'"

Williams' selling coach at HSN's St. Petersburg (Fla.) studio is a lively executive named Christie Miranne-Seipelt who is priming her for her debut, a two-hour sale that begins at midnight. "Start with the bracelet. The up-sell is the matching necklace and earring set," says Miranne-Seipelt. She and her mother, Joy Mangano, a home shopping sensation in her own right, serve as the liaisons between Williams and HSN. Their goal is to match the tennis pro's more youthful, body-baring sensibilities with those of HSN's older, body-conscious shoppers.

A word about the bracelet: It's a woven metal and crystal cuff engraved with "Serena Williams First Anniversary 2010" (Williams launched her Signature Statement collection for HSN last April). It has been designated a "Today's Special," which means it will be mentioned or shown hundreds of times before Williams' visit is over. It's $29.95. "So, we're going to sell the bracelet with the necklace and earrings," says Williams.

"I want you to focus on the bracelet," says Miranne-Seipelt.

"You focus on the bracelet," Mangano says. "Connie [the HSN host] will weave in comments about the necklace and earrings. But the focus for you is the bracelet."

Williams tries out her pitch: "Wear it this way [with the clasp in front] and it's kind of rock and roll."

"You can talk to the fact that you're giving them a luxury look at such an affordable price," Miranne-Seipelt says. "Once these are gone, you're never making them again."

During each of Williams' five shows, Miranne-Seipelt watches the sales figures and gives instructions that the producer passes on to Williams and the host: "Go through the colors for the chiffon scarf. It's the last thing. The price is unbelievable [$19.95]. It feels like silk. The shrug feels like cashmere–lightweight cashmere. One thousand people have bought the jeans. Get those tonight. The dress is flattering on everyone. It's available in black, gray, cream. It was $99. Now it's $49.95. It's classic, it never goes out of style. Pick up the flats...."

The next day, after a two-hour sellathon that ends at noon, Williams lies curled up on the couch in the green room. She pulls a blanket over herself and mumbles, "Can someone get me something to eat?" She goes on: "These visits are getting harder and harder. At the beginning they were very easy. Now it's just not as easy." What's changed? "I don't know. It's like when you're first on tour, you're really eager to play the top players, you want to be the best, you're eager, eager. That's how I felt. Now I've played her, beaten her, let me relax."

During her 24-hour visit, HSN sold $3.25 million worth of products; Williams accounted for about one-third of it. The 1,900 pairs of jeans are gone. So are the maxi dresses. About half the shoes remain, though, and even Serena Williams couldn't sell all 15,000 bracelets. Thanks to her relationship with Grossman, she'll be back to sell another day. Ⓑ


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Special Section

The Tech 100

Apple and Google, get ready to rumble. Chinese and Indian tech companies are coming on strong in *Bloomberg Businessweek*'s annual list of the tops in technology

Wang Chuanfu. Don't know the name? Until a few years ago, neither did Charlie Munger, vice-chairman of Berkshire Hathaway. When Munger checked out Wang's company, BYD, the Chinese maker of plug-in hybrid cars and rechargeable batteries, he was so impressed he persuaded Warren Buffett—legendary for his dislike of tech investments—to buy a 10 percent stake in BYD for about $230 million. That was September 2008. Today, Buffett's piece is worth nearly $2 billion.

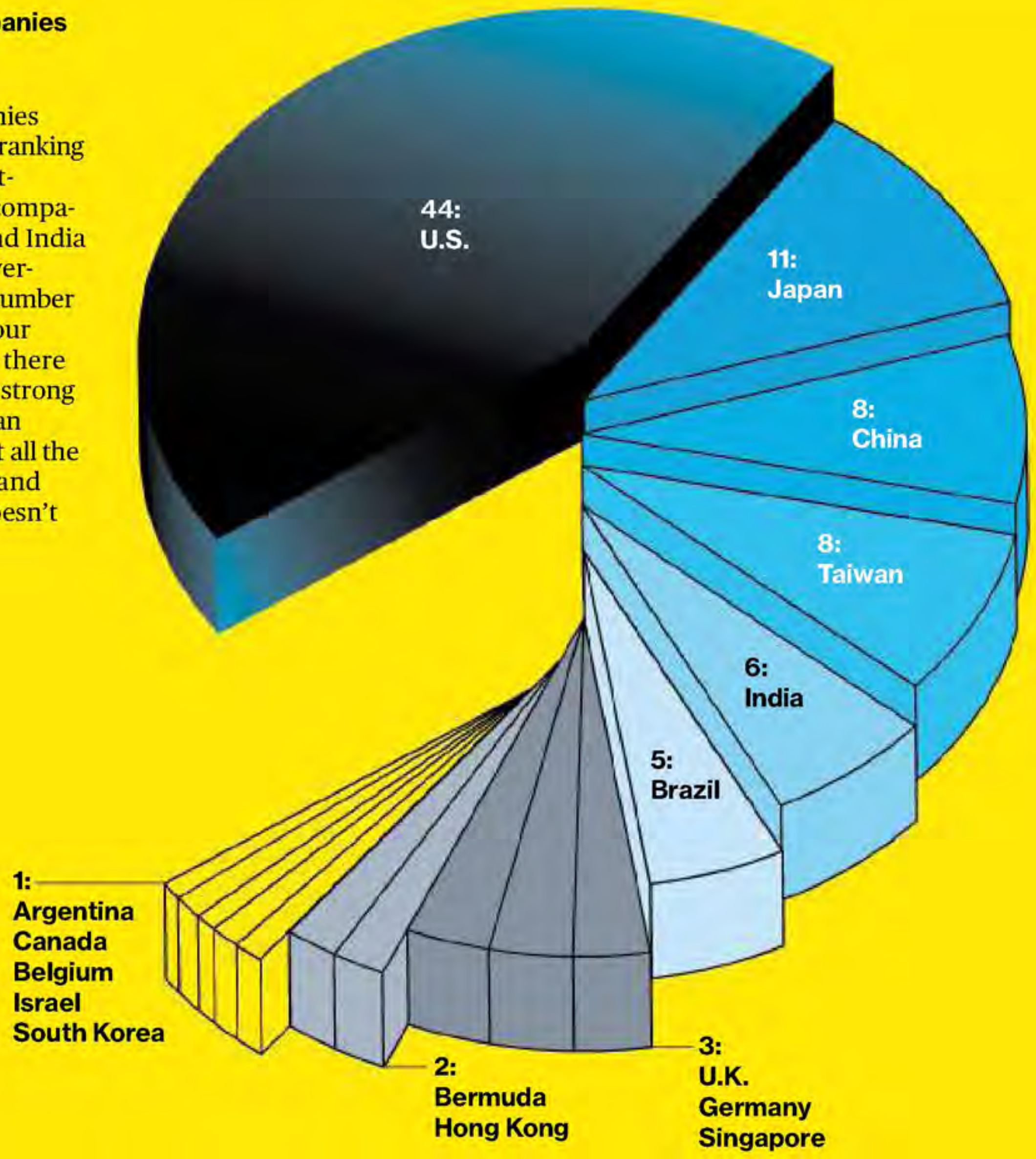
Scan *Bloomberg Businessweek*'s Tech 100 list, and you'll find names familiar and new. From global powerhouses Tata Consultancy and Google to lesser-known players such as Taiwanese chipmaker Phison Electronics and Brazilian e-tailer B2W, these companies have managed to thrive during a bruising global recession. BYD (which stands for Build Your Dreams) has more than flourished: It even outperformed perhaps the hottest tech outfit around, No. 2 Apple.

To compile our list, we started with 6,500 tech companies. We set requirements: a minimum market cap of $1 billion, revenues of at least $500 million, and no more than a 5 percent decline in revenues (in local currency) from 2008 to 2009. We then normalized revenues and operating income to compare the remaining 210 companies, and ranked them on these metrics as well as shareholder return and employee growth, with 1 being the top ranking. Adding them all up, the companies with the lowest-weighted rankings made the list.

The Tech 100: Other Metrics

Number of Companies by Country

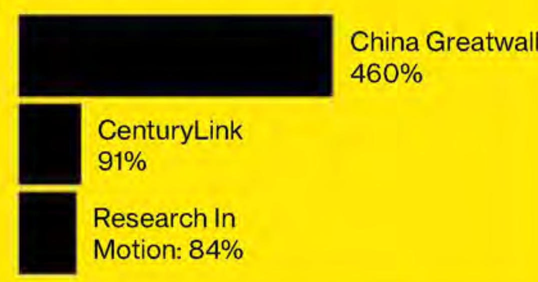
Sure, U.S. companies still dominate any ranking of the world's best-performing tech companies. But China and India are emerging powerhouses, with the number of companies on our Tech 100 right up there with traditionally strong tech countries Japan and Taiwan. Count all the Asian companies and North America doesn't loom large.



The Best Returns
Shareholder Returns (through Apr. 30)



The Fastest-Growing Companies
Revenue Growth



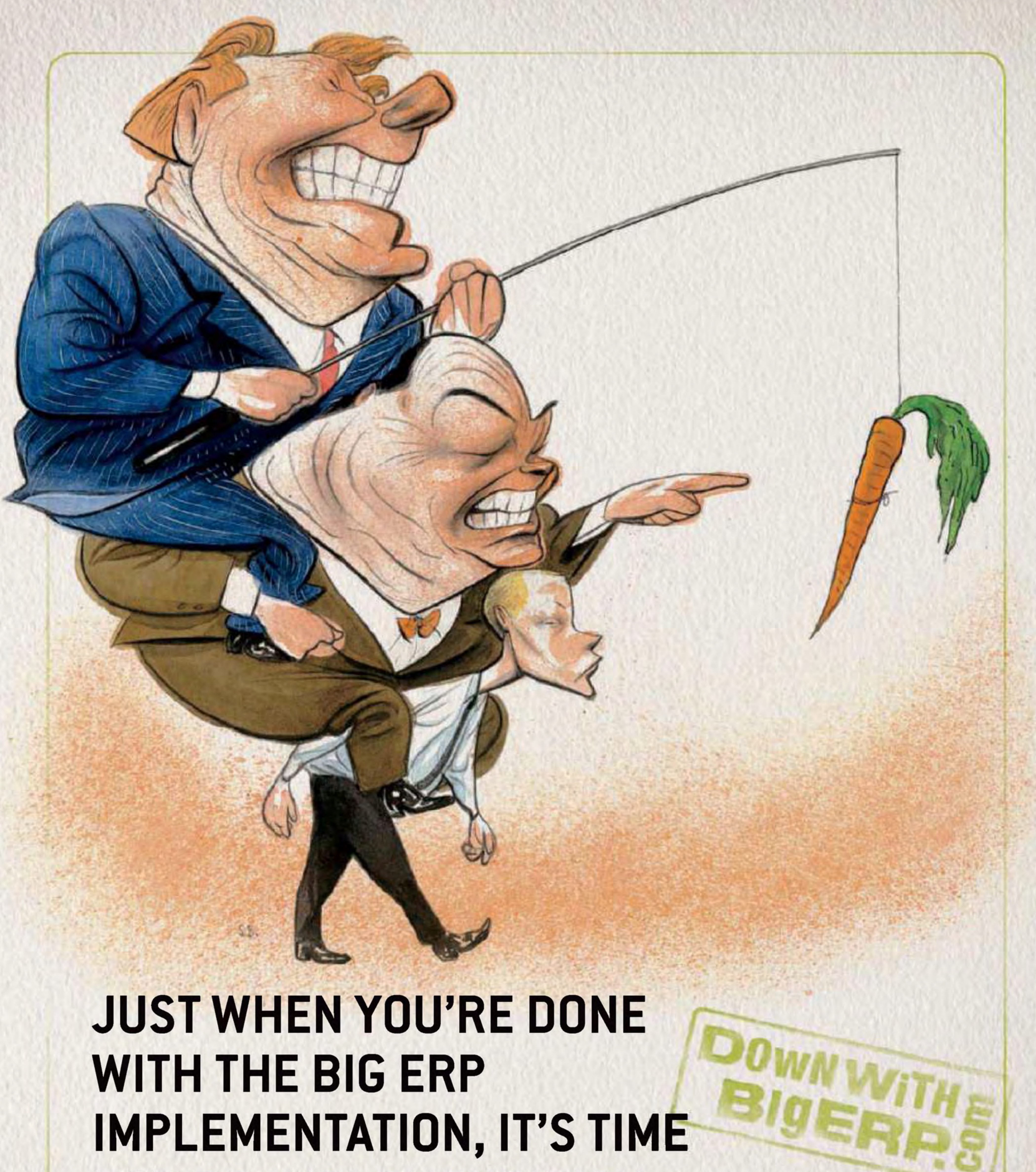
The Most Profitable Companies
Operating Income (millions of dollars)



The Tech 100 List

Name	Country	Industry	Revenue ($MM)	Revenue Growth (%)	Operating Income ($MM)	Shareholder Return (%)
1. BYD	CHN	*Electronic equipment*	5777	50	713	246
2. APPLE	USA	*Computers, peripherals*	42905	14	11740	107
3. TENCENT HOLDINGS	CHN	*Internet software, services*	1821	77	860	138
4. AMAZON.COM	USA	*Internet, catalog retail*	24509	28	1129	70
5. TATA CONSULTANCY	IND	*IT services*	6096	8	1448	150
6. PRICELINE.COM	USA	*Internet, catalog retail*	2338	24	471	170
7. CENTURYLINK	USA	*Diversified telecom*	4974	91	1233	37
8. COGNIZANT TECH.	USA	*IT services*	3279	16	618	106
9. INFOSYS TECH	IND	*IT services*	4754	15	1415	84
10. SOFTBANK	JPN	*Wireless telecom services*	26709	10	3588	36
11. WPG HOLDINGS	TWN	*Electronic equipment*	5960	31	135	146
12. MEDIATEK	TWN	*Semiconductors, equipment*	3499	22	1102	60
13. NTT DATA	JPN	*IT services*	11382	21	985	35
14. RAKUTEN	JPN	*Internet, catalog retail*	3192	32	606	47

Tencent is China's No. 1 online gaming operator and its most valuable tech company, with a $39.5 billion market cap



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Research In Motion is the only Canadian company to make the Tech 100

Name	Country	Industry	Revenue ($MM)	Revenue Growth (%)	Operating Income ($MM)	Shareholder Return (%)
15. **NINTENDO**	JPN	*Software*	18371	25	5548	24
16. **SAMSUNG ELEC. MECH.**	KOR	*Electronic equipment*	4374	10	366	176
17. **WIPRO**	IND	*IT Services*	5632	13	986	105
18. **CHINA MOBILE**	HKG	*Wireless telecom services*	66178	12	22439	19
19. **YAHOO JAPAN**	JPN	*Internet software, services*	2655	15	1345	48
20. **ORACLE**	USA	*Software*	23252	4	8555	35
21. **RESEARCH IN MOTION**	CAN	*Communications equipment*	11065	84	2722	-12
22. **GOOGLE**	USA	*Internet software, services*	23651	9	8312	33
23. **MPHASIS**	IND	*IT services*	875	45	190	205
24. **NETFLIX**	USA	*Internet, catalog retail*	1670	22	187	118
25. **KDDI**	JPN	*Wireless telecom services*	34947	11	4428	6
26. **VISA**	USA	*IT services*	6911	10	3540	40
27. **BAIDU**	CHN	*Internet software, services*	651	41	235	196
28. **ZTE**	CHN	*Communications equipment*	8823	38	551	62
29. **LENDER PROCESSING**	USA	*IT services*	2371	29	532	33
30. **VERIZON**	USA	*Diversified telecom*	107808	11	19480	1
31. **FIDELITY NATIONAL INFO.**	USA	*IT services*	3770	10	415	49
32. **HARRIS**	USA	*Communications equipment*	5005	9	794	82
33. **SINGAPORE TELECOM.**	SGP	*Diversified telecom*	10392	3	1883	24
34. **HCL TECH**	IND	*IT services*	2153	15	357	207
35. **FREENET**	GER	*Wireless telecom services*	5091	25	170	84
36. **TELENET GROUP**	BEL	*Diversified telecom*	1670	11	416	60
37. **SYNNEX TECH. INTL.**	TWN	*Electronic equipment*	6685	11	110	76
38. **SALESFORCE.COM**	USA	*Software*	1077	44	64	100
39. **SOFTWARE**	GER	*Software*	1182	11	281	84
40. **CHINA GREATWALL**	CHN	*Computers, peripherals*	3318	460	39	171
41. **GLOBAL PAYMENTS**	USA	*IT services*	1602	26	309	34
42. **NOMURA RESEARCH**	JPN	*IT services*	3410	13	497	42
43. **EQUINIX**	USA	*Internet software, services*	883	25	180	43
44. **SAIC**	USA	*IT services*	10070	13	776	-4
45. **KINGBOARD CHEMICAL**	HKG	*Electronic equipment*	3067	1	370	131
46. **CHECK POINT SOFTWARE**	ISR	*Software*	924	14	424	54
47. **AUTONOMY**	UK	*Software*	740	47	272	26
48. **CROWN CASTLE INTL**	USA	*Wireless telecom services*	1685	10	453	54
49. **COMPUTER SCIENCE**	USA	*IT services*	16740	1	1211	42
50. **SYMANTEC**	USA	*Software*	6150	5	1667	-3
51. **FIBERHOME TELECOM**	CHN	*Communications equipment*	681	39	41	77
52. **MASTERCARD**	USA	*IT services*	5099	2	2267	36
53. **AMERICAN TOWER**	USA	*Wireless telecom services*	1724	8	672	28
54. **GENPACT**	BMU	*IT services*	1120	8	162	88
55. **BHARTI AIRTEL**	IND	*Wireless telecom services*	8181	22	2263	-20
56. **TOTVS**	BRA	*Software*	501	33	91	108
57. **MISYS**	UK	*Software*	1136	15	176	68

Israel's Check Point outperforms computer security heavyweights Symantec (No. 50) and McAfee (No. 85)



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Name	Country	Industry	Revenue ($MM)	Revenue Growth (%)	Operating Income ($MM)	Shareholder Return (%)
58. **DOLBY LABORATORIES**	USA	*Electronic equip., instruments*	720	12	363	71
59. **RED HAT**	USA	*Software*	653	25	83	73
60. **ITOCHU TECHNO. SO.**	JPN	*IT services*	3070	10	217	65
61. **FLIR SYSTEMS**	USA	*Electronic equipment*	1147	7	347	38
62. **EXPEDIA**	USA	*Internet, catalog retail*	2955	1	673	74
63. **RACKSPACE HOSTING**	USA	*Internet software, services*	629	18	55	95
64. **ATHEROS COMM.**	USA	*Semiconductors, equipment*	542	15	33	126
65. **PHISON ELECTRONICS**	TWN	*Semiconductors, equipment*	741	24	67	63
66. **TELECOM ARGENTINA**	ARG	*Diversified telecom*	3282	-2	741	136
67. **HON HAI PRECISION**	TWN	*Electronic equipment*	59341	-4	2529	80
68. **INTUIT**	USA	*Software*	3183	4	724	56
69. **SIMPLO TECHNOLOGY**	TWN	*Computers, peripherals*	1037	6	101	71
70. **VISTAPRINT**	BMU	*Internet software, services*	516	29	62	50
71. **UNITED INTERNET**	GER	*Internet software, services*	2313	0	503	46
72. **INMARSAT**	UK	*Diversified telecom*	1038	4	363	67
73. **CAPCOM**	JPN	*Software*	919	26	146	14
74. **AUTOMATIC DATA**	USA	*IT services*	8867	1	1830	27
75. **FACTSET RESEARCH**	USA	*Software*	622	8	211	42
76. **TW TELECOM**	USA	*Diversified telecom*	1211	5	114	93
77. **BMC SOFTWARE**	USA	*Software*	1872	8	452	14
78. **CACI INTL.**	USA	*IT services*	2730	13	184	20
79. **FLEXTRONICS**	SGP	*Electronic equip., instruments*	30949	12	457	99
80. **SHANDA INTERACTIVE**	CHN	*Software*	768	47	299	-5
81. **CREE**	USA	*Semiconductors, equipment*	567	15	37	167
82. **SOLERA HOLDINGS**	USA	*Software*	558	3	121	71
83. **AKAMAI TECH**	USA	*Internet software, services*	860	9	224	76
84. **NII HOLDINGS**	USA	*Wireless telecom services*	4398	3	677	163
85. **McAFEE**	USA	*Software*	1927	20	236	-7
86. **LKQ**	USA	*Distributors*	2048	7	234	24
87. **JARDINE CYCLE**	SGP	*Distributors*	10640	-5	1314	122
88. **REDECARD**	BRA	*IT services*	1228	7	747	12
89. **TRIPOD TECHNOLOGY**	TWN	*Electronic equipment*	1012	5	116	109
90. **VIVO**	BRA	*Wireless telecom services*	8293	-3	994	38
91. **AISINO**	CHN	*Software*	1085	25	125	19
92. **YAMATAKE**	JPN	*Electronic equipment*	2360	8	178	46
93. **AUTODESK**	USA	*Software*	2315	7	414	70
94. **CHICONY ELECTRONICS**	TWN	*Computers, peripherals*	1634	6	122	67
95. **MANTECH INTL.**	USA	*IT services*	2020	8	179	25
96. **B2W VAREJO**	BRA	*Internet, catalog retail*	1922	11	182	12
97. **CA TECHNOLOGIES**	BRA	*Software*	4271	0	1229	33
98. **VMWARE**	USA	*Software*	2024	8	219	136
99. **POSITIVO**	BRA	*Computers, peripherals*	1100	3	74	115
100. **KONAMI**	JPN	*Software*	3095	19	273	30

DATA: BLOOMBERG, AS OF APRIL 30

The Bill & Melinda Gates Foundation just added Expedia to its stock portfolio

Shanda Games bought U.S. game developer Mochi Media for $80 million in January



Autodesk's design software helped create the effects in *Avatar*

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Who says khakis aren't hip? Page 81



The Novel Experiment

Researching her book about a novelist-turned-trader, the author got a front-row seat at the financial meltdown

By Martha McPhee

Photograph by Fredrik Broden

RIHANNA: X17ONLINE.COM

I was propositioned by a Wall Street trader. Actually he was a manager of mortgage-backed-securities traders at a well-regarded investment bank. We were at a garden party in the country, and I noted that he had arrived in a chauffeured town car that waited for him. I knew he was a Wall Street type, and I was curious about what he did, and how he, by the look of the car sitting outside, made so much money. He generously explained the job of a mortgage-backed-securities trader and humbly suggested there was nothing to it. Traders were nothing more than used-car salesmen who understood supply and demand, he said. Anyone could do it. Instead of cars, they were selling mortgages, people's puny mortgages bundled together into giant pools, then sold around the globe to insurance empires and pension funds, even foreign countries. This process, he said, had allowed interest rates to drop, making mortgages easier to get and providing a lot more people with the great American dream of homeownership.

I was fascinated. The idea of amassing the small debts of so many dreamers on a colossal scale–a scale bigger than the entire combined value of the U.S. stock markets, as it happened–and chopping them up and sending them around the world seemed like quite a plot. Swept up in my enthusiasm, he told me: "If you give me 18 months, I'll turn you into a trader." This was 2004.

I liked the notion, though I didn't exactly take him up on his offer. I started paying attention to the frothing housing market. I read Michael Lewis' *Liar's Poker* and a collection of interviews with traders called *Market Wizards*. I reread Tom Wolfe's *The Bonfire of the Vanities* and amassed a notebook of clipped articles on the mortgage market. At the time, as we now know, people all across America were buying homes they couldn't afford and everyone was getting rich. Every one of us, it seemed, could own a little tract of America.

> **They bet on everything such as who could identify six different brands of bottled water by taste**

None of it made any sense. Yet amid all the tumult and confusion, I understood that this would be the premise of my next novel: A cash-strapped fiction writer is transformed into a high-rolling mortgage-backed-securities trader by a Wall Street tycoon. I asked my trader if he would help me. "As long as you don't use my name or mention my firm," he said. I was good with that. I could hardly remember the name of his firm anyway.

I visited my trader on a high floor of a glass tower. Through the glass walls of his office, I looked at the sea of impossibly young men at long desks, behind monitors, with the world's economy in the palms of their hands. "They're all aware of you in here," he said. "Bets are already being made: Who's that chick in there? Side bets and hedges, too. You're being traded." I was? "You have market value," he continued, "because you're in here with me."

My trader spoke a mile a minute. He had a fluency with a language that was foreign to me: subprime, Alt A, midgets, gnomes, tranches, and shadow markets. I understood then that I was going to have to work hard in a way I had never before in my career.

By 2005, I began in earnest on the novel. I made one major change–instead of going with my original trader, I decided I needed to focus on a woman, because my main character was going to be a woman.

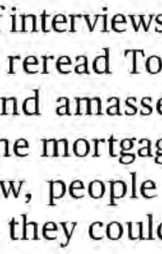
As it happened, through the parents of my children's friends, through family, and through college friends, even I, a novelist, had exposure to quite a few bankers, traders, and salespeople. They welcomed me, offering to help. My next-door neighbor was a former trader, and she provided invaluable advice. One of the first things that struck me was that all of them were literary. They found my

Bond Writing



A chronology of the best novels about banking culture
By Ira Boudway

1925

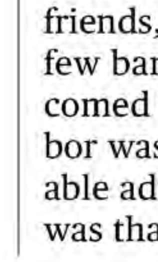


The Great Gatsby by F. Scott Fitzgerald
The classic novel begins with Nick Carraway deciding to "go East and learn the bond business." It ends with his education in "business on the side."

1987

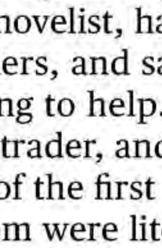
The Bonfire of the Vanities by Tom Wolfe
The author introduces the world to the now ubiquitous coinage, "Master of the Universe," in the form of über-WASP bond trader Sherman McCoy.

1991



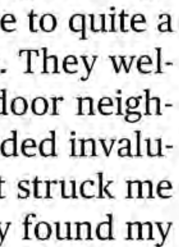
American Psycho by Bret Easton Ellis
Twenty-six-year-old investment banker Patrick Bateman narrates his own exploits in mergers and acquisitions as well as murders and executions.

2002



Moral Hazard by Kate Jennings
A Wall Streeter sees in skyscrapers the "infestations of middle managers, tortuous chains of command, stupor-inducing meetings, ever widening gyres of e-mail."

2009



Union Atlantic by Adam Haslett
This novel centers on a narcissistic director at a Boston bank as he primes the instruments of economic ruin and tries to keep ahead of the Fed.

ILLUSTRATION BY JILLIAN TAMAKI; OPPOSITE: FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK

assumption of a poorly read banker amusing, but above all were tickled that a novelist found their world intriguing enough to write about. They, some even strangers, invited me into their world, took apart the mortgage universe, and then put it back together so that I could understand. Bond traders, it seems, are discreet by nature. Even so they were extremely generous with their stories. They more than supplemented the information I devoured from newspapers, magazines, and blogs.

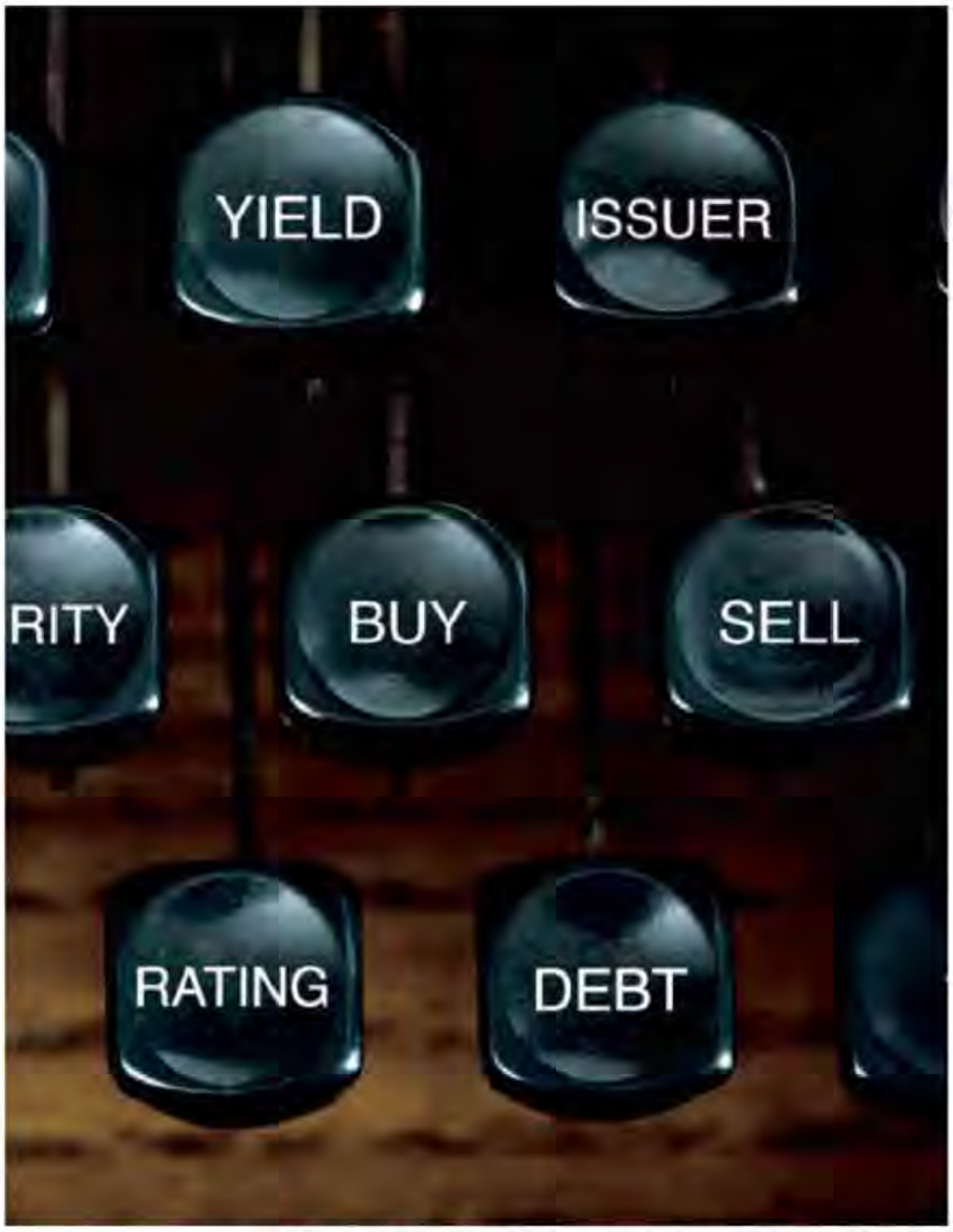
One of the first stories to set my adrenaline going was about a female trader, a rising star and not even 30 years old. I decided that my protagonist would have a job like hers. But the character, India Palmer, would be a 38-year-old mother of two (an old lady in Wall Street terms, I soon learned). "You can't do that," my neighbor, the former trader, said. "It won't be believable. You should put her in sales. That would be believable." It is true that it would have been more likely for someone like India to work in sales. Still, I ignored that advice—the impossible was the point. I wanted to transform an unlikely prospect into a star, Pygmalion-like.

Of all the stories I come across in my research, those about the behavior of traders interested me most. Their military psychologies, the Lombardi-esque metaphors, and the Byzantine hierarchy. Why were some allowed to ride home in a company town car while the others had to take a taxi? They bet on everything and constantly held impromptu competitions amongst themselves, such as who could identify six different brands of bottled water by taste. All believed in bad omens. A watch worn the day a trader got rinsed wouldn't be allowed back on the floor. In the middle of the night, they woke up to check their positions as markets opened across the globe.

From 2005 to 2009, traders answered my questions and unwittingly offered me a front-row seat at the epic mortgage-backed-securities mess that catapulted us into the worst recession since the Great Depression. The most interesting thing to me, once I got beyond the staggering sums of money in play, was how a confluence of events involving the government, bankers, ordinary people, and big dreams had come together to create the imbroglio. I watched the story unfold with all its riveting plot turns and complex characters as traders rode the roller coaster across 2007 and into 2008, and as firms blew up and the economy crashed.

What had been a source of artistic curiosity for me was now writ large all across the world. It was astonishing, as a novelist, to be working on a subject in real time. I was an accidental tourist to what had seemed like another planet with an entirely different species, but by the end it had quite directly collided with the world we live in.

As the collapse unfolded, my writing froze. I had not intended to write a novel about Wall Street



I was an accidental tourist to another planet that ended up colliding with our world

blowing up. Frankly, I couldn't keep up with the news or the implications. For four months, I didn't write. The final chapter languished in my computer. Then it dawned on me: The novel can end as I had always intended it to end. What happened on Wall Street has happened before; it will happen again. My story isn't an attempt to make tidy sense of the global financial system. That, of course, is not the novelist's job.

As a fly on the wall, paying a little more attention than others outside of Wall Street, I saw we were all to some degree responsible for the mess. A blind eye was turned. Having more—a bigger house, more deals, greater profits—had become an American right, a belief. I've come to understand how staggeringly much we know about the world of finance, manipulating numbers, creating products—derivatives, CDOs, and so forth—yet how little we know. As with medicine and deep-water oil exploration, we know so much and not enough. In between the extremes is our own hubris, to which, it seems, we will always be vulnerable. Locating that hubris, however, is a novelist's job. B

Dear Money *by Martha McPhee will be published next week.*

Seeing Double

The Edge includes a 9.7-in. grayscale screen (left) and a 10.1-in. color screen (below)

Shade of Gray
A graphic on the digital-ink side can be opened in color on the adjacent screen



Bright Lights, Little Screen
The color side can access movies and other multi-media clips

The "dualbook" Edge takes aim at Apple and Amazon.

By Rich Jaroslovsky

It has a color screen, costs $499, and runs on a smartphone operating system. And it isn't an iPad. It has a digital-ink screen and downloads books. And it isn't a Kindle. It's the Edge, an e-reader that suggests the Apple-Amazon struggle for dominance in the marketplace still leaves room for innovation from other contenders.

Entourage Systems—or enTourage, as the McLean (Va.) startup likes to call itself—describes the Edge (pardon me, the eDGe) as a "dualbook," a tablet that opens and is held like a book. On one side is a 9.7-inch grayscale screen, the kind found on the Kindle and Sony Reader. On the other is a 10.1-inch full-color, liquid-crystal display with a front-facing Web camera, microphone, and browser. The whole package weighs about three pounds—as much as a netbook and double the weight of an iPad—and runs on Google's Android smartphone software. The device is aimed primarily at a business and academic audience, and the Entourage e-bookstore's offerings lean heavily toward technical, trade, and professional books.

The Edge has two standard (and one mini) USB ports and a slot for a secure digital card, making it easy to load up with documents. It also has a slot for a SIM card—a wireless 3G version is in the offing—built-in Wi-Fi and Bluetooth, and stereo speakers. It even folds inside out like a digital Transformer, putting its screens on the outside.

You can take notes right on the digital-paper screen using the stylus or a virtual keyboard; the notes can be saved, uploaded to a server, or e-mailed straight from the Edge. Entourage claims 16 hours of battery life, but I found it varies depending on your use of the color screen. In any event, the battery is replaceable, so you can carry a spare.

I wanted to like the Edge more than I actually did. The Webcam didn't work in my trial unit (Entourage is only now in the process of updating the software that enables it); the color touchscreen flexed under the pressure of a finger, and the virtual keyboard required you to hit the keys just right. Although the device runs Android, it doesn't have access to Google's wealth of apps. Because the Edge isn't a plausible netbook replacement, some users might still need to lug a laptop along. That's asking a lot.

Entourage deserves credit for putting existing technologies together in an interesting way, creating something new and different in the process. But while it points the way toward the future, it isn't there quite yet. B

PROTECTIVE MEASURES

Two stylish options from the growing business of guarding e-readers.



M-Edge
Platform Jacket (Leather)
Works with: iPad
Price: $49.99



Cole Haan
Hand-Woven Patent Leather Cover with Hinge
Works with: Kindle
Price: $119.99

TOP: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

Etc. Next Life

After the Crash, An Appetite for Risk

Between Thanksgiving and New Year's Day last year, Smith Island Baking sold 1,000 cakes



A former derivatives pro finds a new measure of success—in flour, sugar, and eggs

For more than a decade, Brian Murphy spent six days a week trading commodities like electricity and natural gas—and even weather derivatives. Working his way up at Constellation Energy Group in Baltimore, he was, by the age of 30, overseeing a group that brought in $4 billion in annual revenue.

Then Lehman Brothers declared bankruptcy.

As a counterparty with Lehman on energy transactions, Constellation saw its stock price sink 40 percent, and the company came under siege. Highly paid traders like Murphy were now expendable. He took a severance package in December 2008 and retreated to his family home in Easton, Md.

Options soon poured in. "I could have gone to banks in London or New York or Chicago," says Murphy, now 32, and the father of four. "But I've lived in eastern Maryland since the second grade. My wife and I just didn't want to move."

Instead of returning to trading, Murphy made an unconventional bet on his home state: He decided to open a bakery on remote Smith Island, a small former fishing village with 250 residents, an eight-mile ferry ride from the Maryland coastline. His plan did have some logic. While Maryland's state dessert—an artery-busting 10 layers of yellow cake and chocolate fudge—is named after Smith Island, the area never had its own bakery. (Trivia junkies: Some states even have official snack foods. Louisiana has an official meat pie.) "[My wife and I] said, 'What the heck? Let's start our own company,'" says Murphy. "It was like taking the red pill from *The Matrix*: Once you take it, you can never go back again to your old life."

Smith Island Baking opened its doors in 2009. After a shaky first month that saw the company gross only $248.50, word of mouth and a feature in *The Washington Post* started some buzz. Smith Island now boasts 20 employees (including 17 bakers) and ships to 48 states.

As further proof of his commitment to his home state, Murphy recently announced that he's running for governor of Maryland. Although he is widely considered a long shot, the Republican candidate is hoping to create jobs both inside and outside his bakery. —*Chris Taylor*

PHOTOGRAPHS BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK

Fudge-laden Smith Island cakes weigh eight pounds each



FROM TRADING COMMODITIES TO BAKING CAKES

- **Cost of 10-layer Smith Island cake, depending on size and flavor:** $29.25 to $45
- **Cake weight, in pounds:** 8
- **Hourly pay for bakers:** $15
- **Sampling of key ingredients used in an average week:** 50 pounds butter, 100 pounds sugar, 100 pounds flour, 420 eggs, 1.5 gallons vanilla
- **Total revenue over 2009 winter holidays:** $60,000
- **Number of cakes expected to ship for same period this year:** 3,000
- **Calories per cake (est.):** 8,720
- **Number of cakes per month ordered by local insurance company:** 70
- **Ultimate revenue goal:** $1 million a year
- **Pounds gained, owner:** 0

DATA: SMITH ISLAND BAKING, *THE WASHINGTON POST* (CALORIES)

Etc. Executive Itinerary



Korea's sporty second city hosts next week's G-20—good news for outdoorsman extraordinaire Tim Geithner!

Nurimaru APEC House, site of the G-20 meetings







Westin Chosun Beach Hotel is the city's top resort

Busan, Korea

Between the sights, the sports, and the salons, Busan is a perfect city for Tim Geithner

Busan, Korea might seem like an unusual gathering site for next week's G-20 summit, but it's a great spot for Timothy Geithner to spend a few days. Besides being Korea's second-largest city (behind Seoul, 200 miles north) and the country's busiest port, the 3.6 million-person hub teems with activities, restaurants, and shops to fit the active tastes of the U.S. Treasury Secretary and other exercise-inclined finance ministers and tourists.

The G-20 meetings will take place June 4-6 at **Nurimaru APEC House**, a Space Age structure perched on Dongbaek Island next to **Haeundae**, a popular beach resort. Since he's used to wave-riding off the quiet beaches of Cape Cod, Geithner may prefer the surf scene at the nearby **Songjeong**, a less crowded beach dotted with board rental shops. He might even befriend local surfers who hang out at its recently renovated two-story clubhouse.

Back on Dongbaek Island (actually a peninsula), the city's coolest accommodations are at the striking **Westin Chosun Beach Hotel**, where rooms overlook the **Haeundae Beach** or the city's curvy, brightly lit **Kwangan Bridge**. Joggers are advised to start their days by looping through the pagodas and camellia trees that line the island's landscaped trails. For a more grueling workout, there's a climb to the fortress walls and gates atop the 2,600-foot **Geumjeongsan** mountain. Later, since the Obama financial team likes to work out their differences on the tennis court, Geithner and his aides should try **Songdo Beach's Annam Park**, steps from downtown. (The park's breakwater would be another boon to Geithner, an avid fisherman.) In case anyone forgot sneakers, there is a giant Nike outlet in **Shinsegae Centum City**, the world's largest shopping and entertainment center, with over 680 stores. The mall houses an ice skating rink, a rooftop golf range, and **Spa Land**, Asia's largest public bathhouse, with 22 different types of tubs and 13 sauna and massage rooms.



Busan is a haven for surfers like Geithner (photo illustration)



Local surfers catch waves at Songjeong



It's a steep climb up the Geumjeongsan mountain



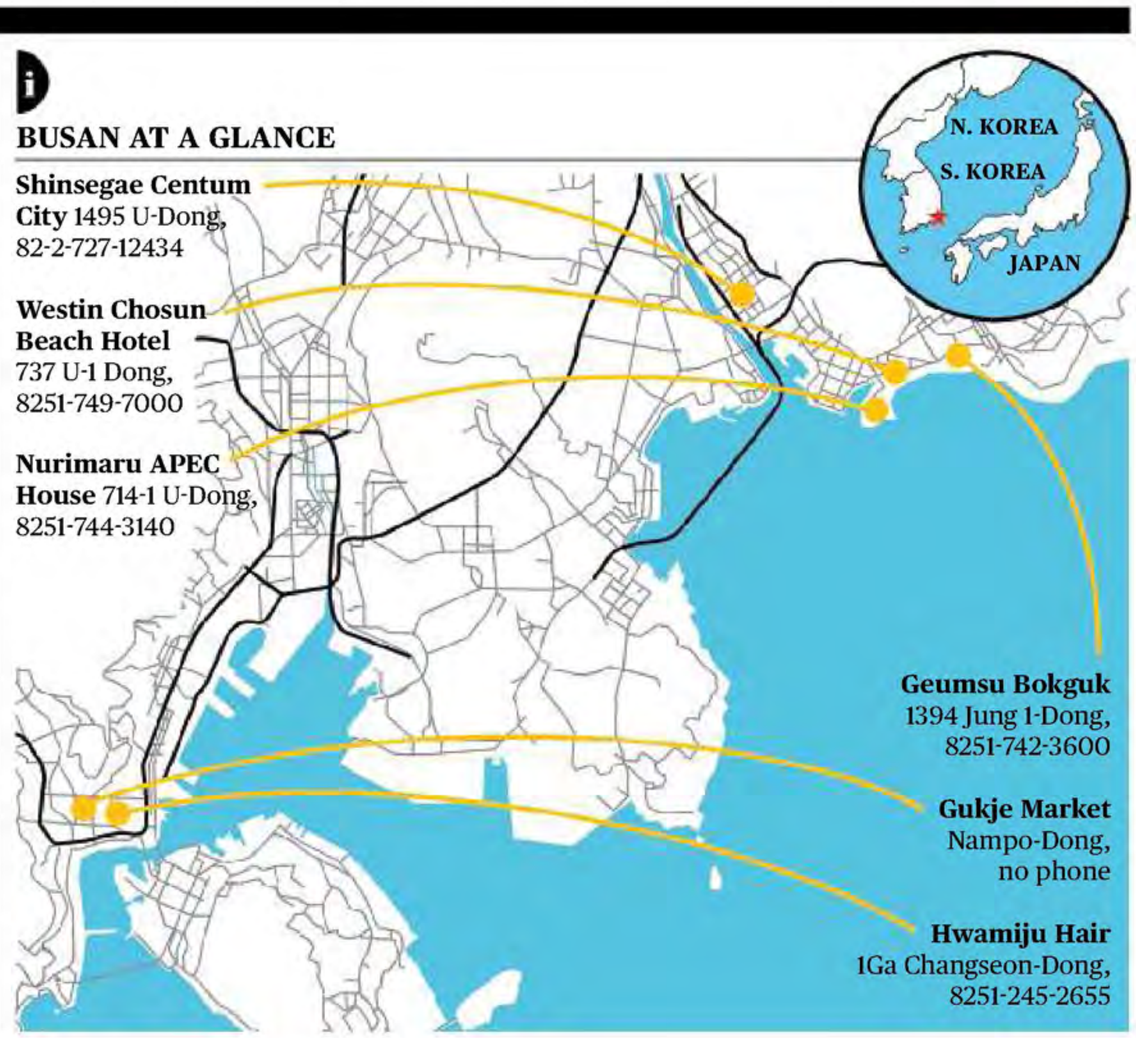
The Beomeosa Temple is an escape from the economy

A very different shopping stop is **Gukje Market**, a warren of stalls in Nampo-dong that's a great place to buy presents to bring home: The open-air market brims with Korean drums, leather handbags, and locally made clothes. The perfect time to discuss the global economy with fellow delegates is over a dinner of pajeons (green onion pancakes) at **Dongnae Halmae**, or the catch of the day at **Jagalchi Fish Market**, packed with restaurants and stalls. If any delegate pines for spaghetti in cuttlefish ink or ravioli, Busan has a wealth of Italian restaurants, most notably **Il Mare**. Of course, more venturesome eaters should try the potentially poisonous blowfish at **Geumsu Bokguk**, a Haeundae restaurant where servers swear the dishes are safe.

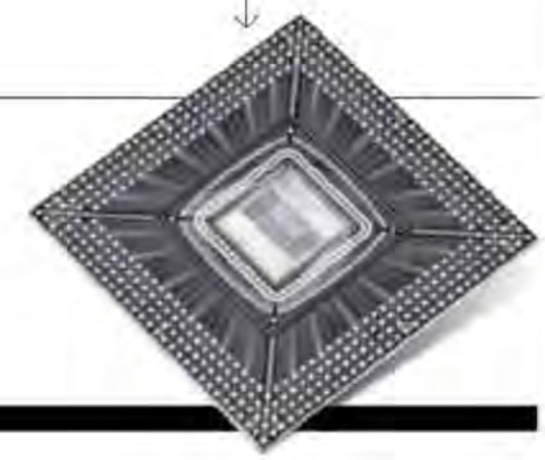
In order to fight off travel-induced frowzy before photo ops, economic envoys might hit **Hwamiju Hair**. A branch near the convention center is staffed with English-speaking stylists. And if those G-20 meetings drive Geithner to distraction, we'd suggest he add 24 hours to his itinerary to join the temple-stay program at the Buddhist **Beomeosa Temple**: The serene mountainside spot seems far away from the world and its obstreperous economy. B —*Simon Richmond*

GEITHNER: WIN MCNAMEE/GETTY IMAGES; NURIMARU: YOU SUNG-HO/REUTERS; SURFING: YONHAPNEWS AGENCY/NEWSCOM; TEMPLE: JTB/PHOTOSHOT; GEITHNER: SAJJAD HUSSAIN/AFP/GETTY IMAGES; SURFER: FOTOSTOCK AMERICA

BUSAN AT A GLANCE



Invest in



Stocking Up on Software Plays

Tech fund manager Paul Wick likes the fat profit margins and recurring revenues in software

There are a lot of positive trends in the tech industry, from semiconductor companies restarting their spending on new plants and equipment to ongoing miniaturization, social media, and videoconferencing. When I add up all of those factors, I conclude that there is a reasonably good upside for tech stocks between now and yearend.

The economics of the tech industry are stronger than many other sectors. Tech gets cheaper and cheaper, which expands the overall pie of people who can afford items. In developed and emerging markets there is a global trend toward greater spending on tech goods and services. People are spending less disposable income on apparel and food, and more on tech gadgets and services.

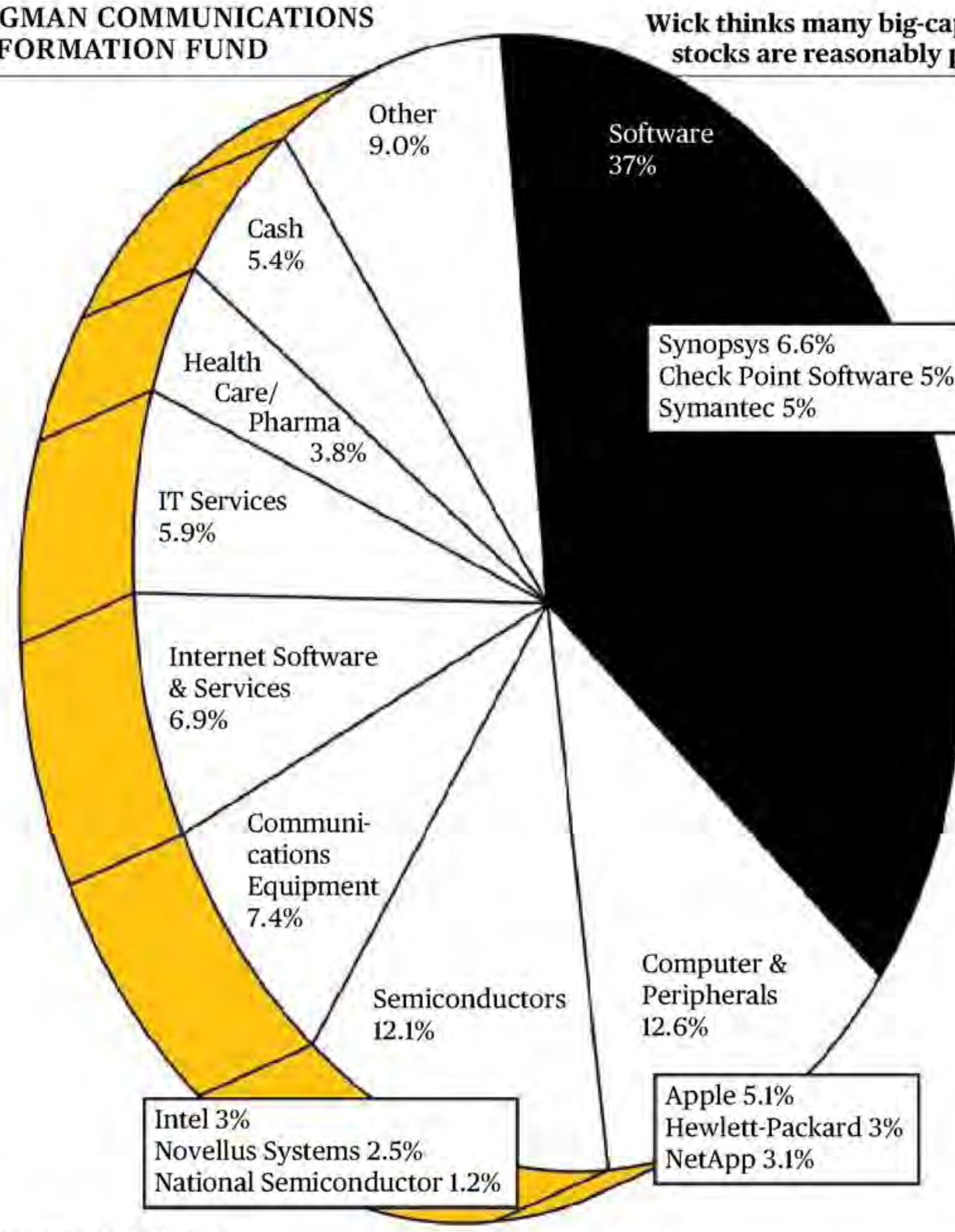
Many tech stocks are still quite reasonably priced, especially big-cap companies like Microsoft, which is one of our top 10 holdings. A good chunk of the fund is in software, where big swaths of the industry are very modestly valued. Software is a more predictable, stable, defensive business. The companies generate tons of cash, usually with pretax profit margins between 20 and 50 percent.

Check Point Software Technologies, which we own, is one of the most profitable companies on the planet. Its pretax profit margin is 50 percent. Since it doesn't have to spend money on new factories, it frequently plows that money into acquisitions, stock repurchases, or dividends. Two other software stocks we own, Symantec and BMC Software, once you strip out excess cash from their market capitalization, trade at eight or nine times trailing 12-month cash flows. One risk for them is they garner 30 percent or more of revenues from Europe. With the euro losing value against the dollar, it is a modest hit to the earnings of both companies.

Our largest position is in Synopsys, the leading company in electronic design automation, which is the business of selling software used to design chips. It sells to virtually every semiconductor company in the world, including Cisco and Apple (which is one of the fund's top three holdings). Synopsys' products are crucial building blocks in the overall technology food chain. With the recovery in the chip industry, Synopsys will see an uptick in its business over the next year or two. At around 22 it's a bargain, with over $7 a share in cash, and 90 percent of its revenues are recurring, from three-year contracts.

SELIGMAN COMMUNICATIONS & INFORMATION FUND

Wick thinks many big-cap tech stocks are reasonably priced



DATA: COLUMBIA MANAGEMENT

We prefer companies delivering profits now, as opposed to *mañana* stories like clean tech

We prefer companies that are delivering profits and cash flow now, as opposed to *mañana* stories like clean tech. Pretty much every hydrogen fuel cell company has been a disaster. Clean coal has been a flameout. We have been very careful with some of the recent alternative-energy initial public offerings. They capture peoples' imaginations. For whatever reasons, people ignore negative cash flow and the fact that there is tremendous uncertainty about the future of the clean tech industry. Ⓑ —*As told to Ben Steverman*

The Stats: Paul Wick has managed the $3.7 billion Seligman Communications & Information Fund (SPCIX) since 1990. The fund's five-year annualized return of 10.6 percent ranks it in the top 6 percent of Morningstar's tech fund category, as of May 12.

CHIP: BUSINESS WIRE VIA GETTY IMAGES

Men's Khakis

How to work and play without breaking your stride

The Need: Sleek enough for the office, and able to withstand a game of touch football. No pleats, no cargo pockets, no cuffs.

The Get: The Woolrich Woolen Mills Ranger Pant ($265, revolveclothing.com) is made of midweight, organic cotton in a flattering cut (slim and slightly tapered). The high rise and flat front minimize paunch, and industrial-inspired details like slit pockets create a look that's equal parts rugged and refined. Ⓑ —*Stephen Treffinger*



Slit pockets once held combs; today, they fit cell phones



Woolrich has produced hunting and fishing gear for 180 years, but its high-end, vintage-inspired line is helmed by Japanese aesthete Daiki Suzuki.



WOMEN'S KHAKIS

Estee Stanley, who has dressed Demi Moore and Penélope Cruz, on how to style your favorite pairs:

Add heels

Wearing chinos with flats can look stodgy; stilettos make them infinitely more glamorous.

Accessorize

There's no outfit more polished than tailored khakis worn with heels, a dress shirt, and a silk scarf. They also look great with a cropped jacket and fitted tank.

Take celebrity cues

Khakis are worn well by Jennifer Aniston (baggy, cuffed, with a fitted T); Rihanna (high-waisted with a shrunken jacket and five-inch heels); and Ashley Olsen (above, in slim khakis, a loose top and classic pumps).

KHAKIS: PHOTOGRAPHS BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; OLSEN: JAMIE MCCARTHY/GETTY IMAGES

Before joining DreamWorks, Spielberg kept a motorcycle in his office in case he needed to make a getaway



ILLUSTRATION BY JOHN RITTER

Requiem for A DreamWorks

DreamWorks was founded to rule Hollywood. Too bad it never worked out. *By June Thomas*

The Men Who Would Be King is a jarring title, but it is entirely appropriate for Nicole LaPorte's exhaustive history of DreamWorks SKG. The Hollywood studio with towering multimedia ambitions was founded in 1994 by three of the entertainment business' most respected—and feared—power players. Director Steven Spielberg, jilted Disney executive Jeffrey Katzenberg, and mogul David Geffen were already royalty when they decided to form the company. This book explores why these monarchs tried to become emperors, and how they almost did.

When DreamWorks was founded, Geffen told reporters that for the first time in his career he wanted to work with partners. In LaPorte's view, DreamWorks was really a hydra of "lone wolves who came together" in the face of canceled TV shows or intra-industry rivalries but "who otherwise tended to their separate fiefdoms."

Each brought his own skills and agenda. Despite having created a management firm, built and sold two record companies, and beaten cancer, Geffen "wasn't chemically suited to sitting on the sidelines," writes LaPorte. Katzenberg, a workhorse who would bear the brunt of day-to-day management, came to the company shortly after being ousted at Disney by Chief Executive Officer Michael Eisner. For Katzenberg, it was crucial not only that DreamWorks should succeed but also that Disney should fail.

Geffen and Katzenberg believed Spielberg would be the artistic magnet to draw directors and screenwriters to the company. Why would a man who could direct or produce any project he wanted take on the added stress of a startup? LaPorte suggests Spielberg's motivations were, in part, psychological. A child of divorce, he had grown up with his mother and sister and longed for fraternal bonding. He was also a sentimentalist who wanted to build an artist-friendly studio—a throwback to the early days of United Artists, which was founded and operated by creative people—even though renting existing office space and sound stages was more efficient.

DreamWorks stared down environmental protesters and devoted time and money to build Spielberg's Xanadu, a new studio lot at Playa Vista in Los Angeles' Westside. When the plan was eventually abandoned, after much fanfare and expense, Spielberg

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The Men Who Would Be King: An Almost Epic Tale of Moguls, Movies, and a Company Called DreamWorks

By Nicole LaPorte
HOUGHTON MIFFLIN HARCOURT; 512 pp; $28



was bitterly disappointed. His commitment, however, had always been suspect. In the early years, when DreamWorks was desperate for product and operating income, Spielberg accepted lucrative offers from other studios, such as Universal, and made some of his most commercially successful films, like *The Lost World: Jurassic Park*, for them.

Katzenberg devoted his energies to running DreamWorks' animation studio, television production arm, and video game division, and to micromanaging "live-action" marketing and distribution efforts. Despite this burden, he refused to concede any territory, and even took on an open development position lower on the org chart than Spielberg's management team. In this position he failed to accomplish the most important task: dramatically increasing the number of films DreamWorks churned out each year. However, DreamWorks' ability to scatter stardust skillfully was immensely useful. Early on, Microsoft co-founder Paul Allen eschewed taking an interest in Pixar and, seduced by Geffen, invested nearly $500 million in DreamWorks in exchange for an 18 percent stake (which he eventually increased to 24 percent).

DreamWorks SKG enjoyed some critical and commercial successes—*American Beauty*, *Saving Private Ryan*, *Gladiator*, *Shrek*—but as LaPorte chronicles in sometimes wearying detail, as with most studios there were more misses than hits. The company could never produce enough movies to justify its overhead, and expensive bombs like *Sinbad* and *The Road to El Dorado* threatened its survival. DreamWorks' multimedia ambitions ultimately came to nothing: the television, video game, Internet, and music divisions were out of sync with the times, and all were eventually shuttered or sold. DreamWorks Animation spun off and went public in 2004; it is now run by Katzenberg. Backed by an Indian company, Reliance Entertainment, Spielberg still makes movies under the DreamWorks name, but they are distributed by Universal. Shortly after masterminding the deal with Reliance, in 2008, Geffen left the company for good.

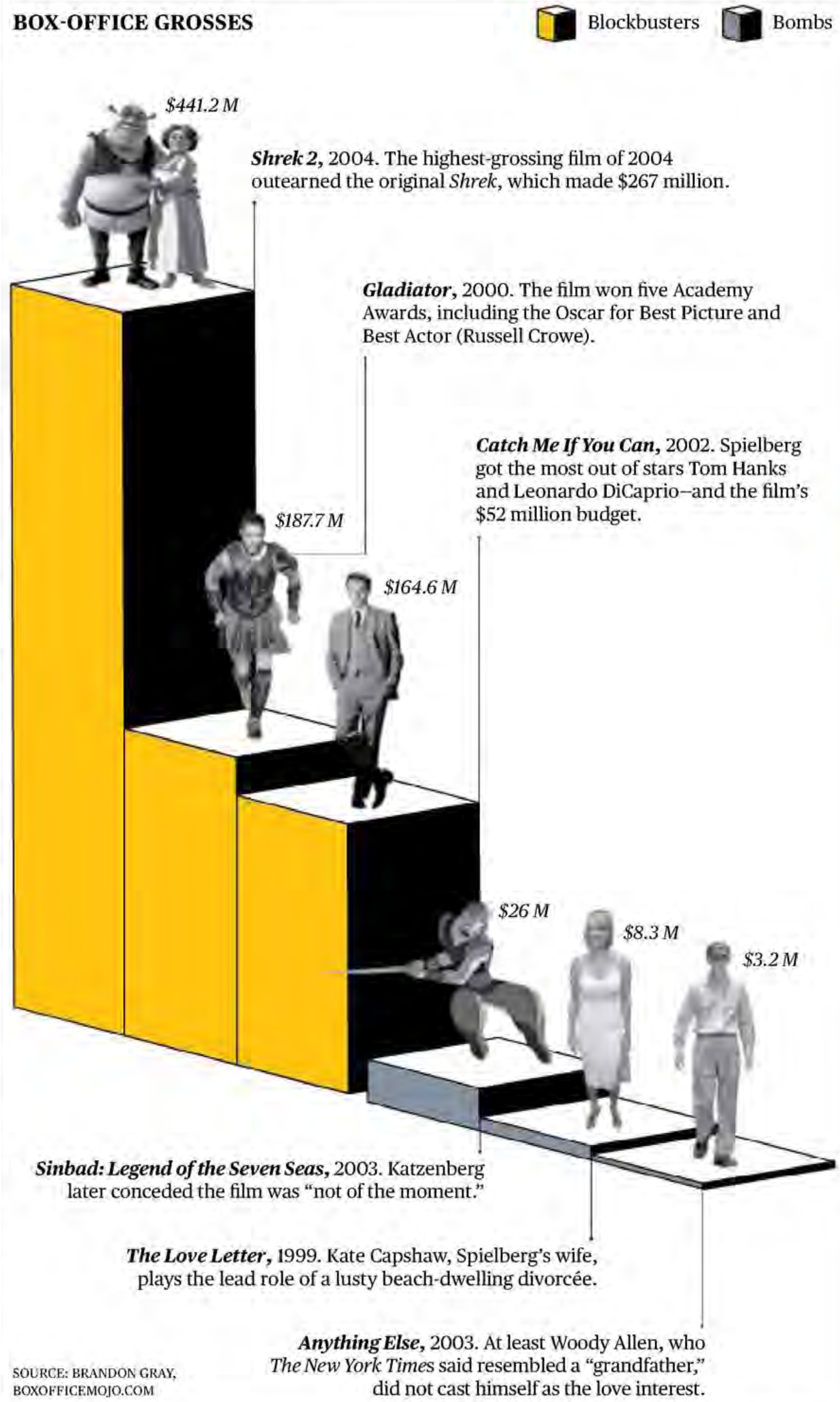
All three principals made a decent profit in the end, cashing out for more than $175 million each after an investment of $33 million apiece. Paul Allen came out ahead, too. LaPorte suggests it was the rank-and-file employees who lost, having waved goodbye to stock options and other perks when they were tempted away from more conventional jobs.

It was a startup without a strategy, a company whose visionary leaders were indulged instead of held accountable. They thought they would be successful simply because of who they were. They were all wrong. B

Close-Up on the Numbers

Like most studios, DreamWorks has had its share of hits and misses. Here are some of the company's biggest blockbusters —and bank-breaking bombs.

BOX-OFFICE GROSSES



SOURCE: BRANDON GRAY, BOXOFFICEMOJO.COM

SHREK, CROWE, DICAPRIO: DREAMWORKS/COURTESY EVERETT COLLECTION; SINBAD: DREAMWORKS/COURTESY NEAL PETERS COLLECTION; CAPSHAW: EVAN AGOSTINI/GETTY IMAGES; ALLEN: NEAL PETERS COLLECTION

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FSC Mixed Sources

John Legere

"Nothing prepares you for walking into the Congress.... You don't know what anonymous e-mails they're going to read"

The Global Crossing CEO recalls his decision to endure a pounding in Congress, stick by his company, and lead it out of Chapter 11



In October 2001, I became CEO of Global Crossing. The company was in a lot worse shape than I thought. I brought in some consultants, and I remember being angry when one of them suggested that we were headed into bankruptcy.

He was right. In January 2002, I agreed to file. This was in the midst of Enron, WorldCom, and Tyco. The brand image was horrible. I was getting threats, and my family needed armed security. I thought to myself, "Wait a second. I just got here!"

They wanted Gary Winnick at the congressional hearings. He was the chairman, but I insisted that I go instead. It was important to put a different face on the company. I went to people I trusted and asked their advice. It was clear that I had to stick around. Otherwise, I would be forever associated with all of the negativity.

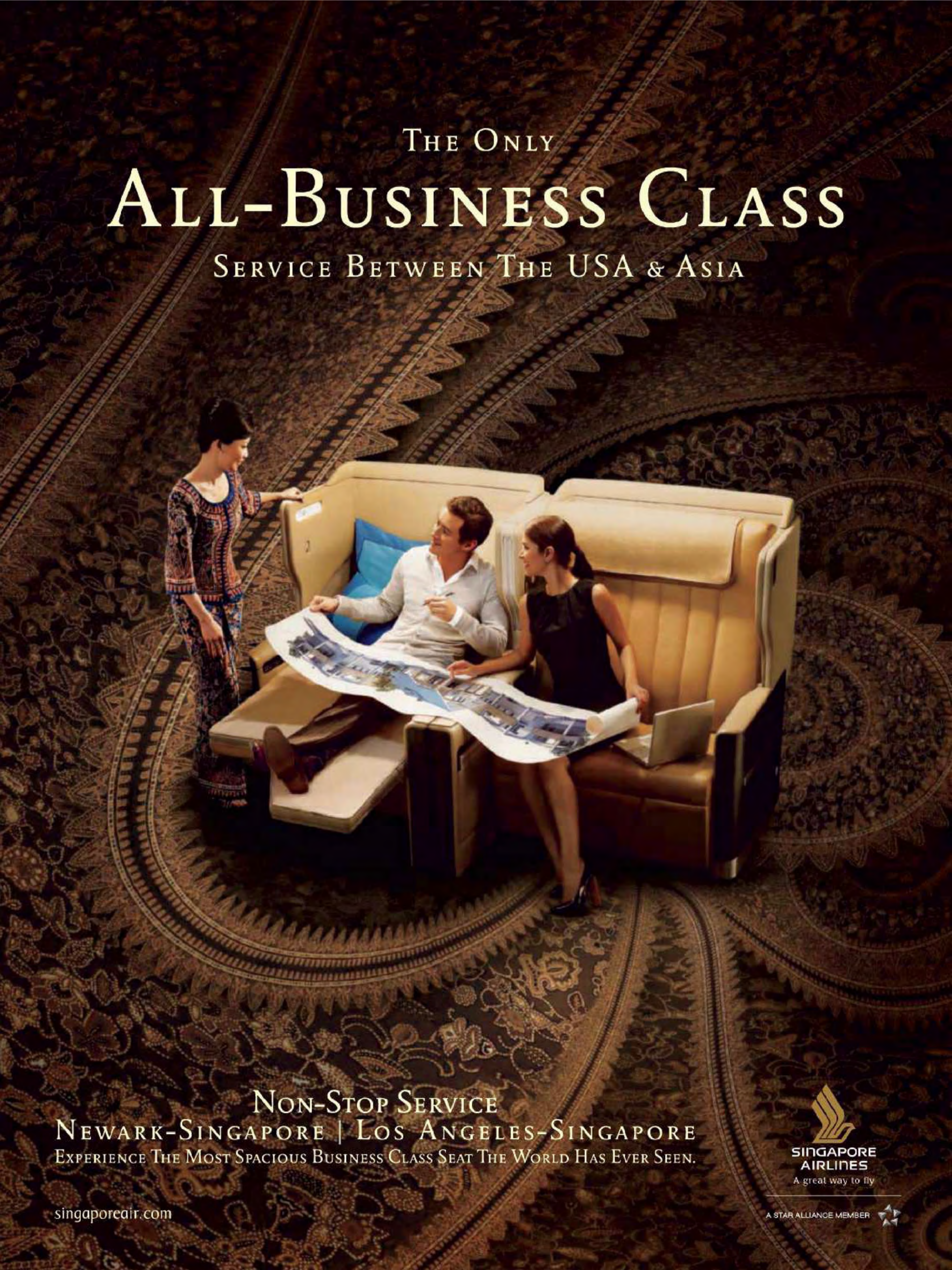
Nothing prepares you for walking into the Congress and sitting in that chair. They're talking to you from up above. You don't know what anonymous e-mails they're going to read, but your lawyers have handed you the most embarrassing ones you've written, just in case they come up.

The stress is intense. I did falter. I got into a tussle with a congresswoman who was pounding the table and screaming: "Mr. Legere, with that signing bonus, how many jobs could you have saved?" As she screamed at me the third time, I leaned forward and said: "I don't do math in public."

It was supposed to be a joke. I was on the cover of *The New York Times* with my face bloated and my eyes red. I looked horrible. I was overeating. I was overdrinking. I would put three espressos on ice so I could drink them faster. My brother called to say, "You look like you're going to die." I made a conscious decision: This wouldn't beat me. And we got through it. In December 2003 we emerged from Chapter 11. We were ultimately not found guilty of any wrongdoing. This could have been one of the most successful telecom stories ever. It still could be. And I'm still here. Ⓑ

—As told to Diane Brady

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK


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